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Restaurant Business

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FACING THE CONSTRAINTS ON GROWTH

Restaurant Business

Roundtable I

The economic signposts tell us our industry has reached a strategic crossroads. Increases in the food-away-from-home CPI, oil prices, and interest rates—combined with declines in disposable income—have resulted in customer count drops. In spite of these problems, industry leaders in a special Roundtable convened by *Restaurant Business* found reasons for optimism.

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Restaurant Business

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RESTAURANT BUSINESS
CUSTOMER TRAFFIC
MANAGEMENT DEVELOPMENT
DEMOGRAPHICS • INDUSTRY FORECAST
• OIL PRICES • MINIMUM WAGE HIKES •
REAL GROWTH • FOOD-AWAY-FROM-HOME
• SALE/LEASEBACK PROGRAMS • TRAVEL •
TRAINING • DISPOSABLE PERSONAL INCOME
FOOD-AT-HOME • AVERAGE UNIT SALES
PRIME RATE • STRATEGIC PLANNI
FOOD INFLATION • EMPL
ROUNDTABLE

FACING THE CONSTRAINTS ON

The economic environment which facilitated the rapid growth of the restaurant industry appears to have been replaced by a much harsher environment over the recent past. Industry observers no longer forecast spectacular growth rates; instead indicators point to the increasing maturity of the industry. It appears, therefore, that the restaurant industry is at a strategic crossroads. Should firms participating in this industry consider major changes in strategic direction? If so, what are the key issues? What will be the key factors of success in the future? To address these strategic concerns, *Restaurant Business* Magazine and Touche Ross co-sponsored a Business

GROWTH

Roundtable participants: (l. to r.) Frankel, Cooper, Barksdale and Harris.

Roundtable, consisting of a select group of industry leaders and experts. The objectives of the Roundtable, which was held at the Pontchartrain Hotel, New Orleans, on January 15-16, 1981, were as follows: (1) To provide a forum for pragmatic discussion of the strategic issues facing the industry; (2) To draw upon a wide variety of perspectives on the industry. We publicly thank the participants for giving so freely of their expertise. The editors of *Restaurant Business* have condensed the group's discussion into the individual presentations that follow.

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Robert Emerson

Analyst/Manager

Fred Alger Co., Inc.

I have some concerns about the outlook for the restaurant industry that I never had in the past.

There are three ways to create a dynamic, rapidly growing, successful company:

The first way is to create a product based on a superior technology, as for example, Xerox and Polaroid.

The second way is to take a static industry and create a new concept. Under this approach, a new participant comes along and steals market share very quickly in a sleeping industry. An example might be Federal Express which is succesfully competing with the U.S. Postal Service.

The third approach is to rationalize a fragmented industry. This approach has led to remarkable success in certain cases—for example, in the trucking industry—and it seems to be the key to the successful restaurant company. There has not been a dramatic growth in the incidence of eating out. The growth of leading restaurant chains has been the result of capturing share of market from independent operators.

At one time, I believed the growth of the chains would probably go on uninterrupted until such time as they had achieved the maximum attainable market share. The reason I thought progress toward the ultimate day of reckoning was going to be smooth was that the industry sailed through the 1974-1975 recession, which was the most difficult economic period since the 1930s.

However, more recent developments have led me to change my long-term outlook for the industry.

I think one thing the industry has been suffering through is the difficulty experienced by most restaurant chains in making the transition from small entreprenurial ventures to large, professionally managed companies—a difficult transition for any company.

Another thing I have seen from the vantage of hindsight is that several restaurant companies appear to be making serious strategic errors. For example, Winchell's Donut Houses went on television in Southern California and in effect created a market umbrella for mom-and-pop competitors. And Long John Silver's cut the size of its fish portion to protect margins when the cost of fish shot up dramatically.

But such mistakes have produced only temporary setbacks, in many instances. And we have seen companies, such as Long John Silver's, Ponderosa, Hardee's and Kentucky Fried chicken, make dramatic recoveries from their problems of the mid-1970s by changing their approach to their businesses. Now, these certainly represent encouraging signs that the industry's strategic errors can be straightened out.

However, as we move into the 1980s, a number of factors that impact on the industry have changed for the worse. I am not talking about simple or individual changes in managerial style. I am talking about structural changes in the industry which seem to me to indicate the possibility that its potential for continued rapid growth is now becoming less promising.

Let me cite some danger signals that I see for the industry:

- In 1973 and 1974, as the cost of beef rose rapidly, menu prices of most restaurant companies also rose. When beef cost dropped, no-one in the industry lowered his prices. That dramatically built up the profits of the chains in 1973, 1974 and 1975—a period of recession. However, we all noticed that in 1979—when the price of beef dropped temporarily—McDonald's for the first time used a cut in menu prices as a marketing tool. That disturbs me.
- In the past, some companies have been perfectly willing to use their own funds or to borrow funds in order to finance company-operated restaurants. Today, they appear to be less willing to risk their own capital to open restaurants. Companies even in high growth areas—instead of opening company units—are taking the franchise route and letting someone else put up his money.
- Also in the past, during a period of tight money and high interest rates, companies like McDonald's have tended to accelerate store-opening programs as real estate prices softened. We are not seeing that happen this time around. It seems to me, it is getting a lot more difficult to open profitable new stores.

Stenographer records the minutes of the RB Roundtable that consisted of a blue-ribbon panel of industry experts . . . and

The constant dollar profits per unit for new stores are below those of existing stores. This points toward saturation.

One can only hope that when the growth fades in the restaurant industry, companies in the business will be able to make a smooth transition into highly profitable, high-cash-flow businesses that earn 25 percent after taxes on net worth even though their company units don't grow. I can certainly get use to a business that pays out all of its earnings.

There is a basic flaw in the restaurant industry. The flaw is that growth appears necessary for success. In other words, growth is necessary to keep people at the store level motivated.

There probably is nothing more disturbing in the world than being an assistant manager of a restaurant working 60 or 70 hours a week—working for really not much more than the minimum wage—and not have much hope of moving up. The only way to keep someone like that highly motivated is to promise him a future of raises and an opportunity to move up to district manager, regional supervisor, and even divisional vice president. The promise of this career development can exist only in a chain that is opening additional stores.

If you reflect on why it is that operations deteriorated for companies like Kentucky Fried Chicken, you probably will find that there was a decline in quality, which inevitably led to a downward sales spiral. This decline will come pretty close to that point in time when these chains stopped opening new units.

> "There is a basic flaw in the restaurant industry. The flaw is that growth appears necessary for success . . . growth is necessary to keep people at the store level motivated."—**Emerson**

Given all the factors pointing to industry maturity, I see three different kinds of opportunities for companies in the foodservice business:

1. You can sell your company. But this doesn't really solve the problem: it just transfers it to someone else.

2. You can develop growth in foreign markets, but this may take a decade to accomplish.

3. You can grow through diversification. One way this can be accomplished is by transferring the expertise developed in the foodservice industry to other fractionized retail industries. The path to success may not be finding ways to grow by opening another kind of restaurant; but instead, it may lie in transferring your expertise to the management of other small service-oriented operations. Shoe repair, beauty parlors, flower shops, and jewelry franchises are just a few potential areas for penetration by well-managed service companies.

leading chain operators who discussed the challenges and opportunities that they face in the 1980s.

George Rice

President

GDR Enterprises, Inc.

Because the restaurant industry through most of the 1970s was able to achieve year-to-year increases in real growth—a performance not even marred by the 1974-75 recession, we thought we were recession-proof. However, the industry's back-to-back years of negative growth in real dollars during this recent recession have exposed the fallacy of our so-called invincibility.

In the past, we didn't understand the key macro-economic variables which drive our industry—forces which worked in our favor during the 1974-75 recession, and some of which turned against us in 1979-80.

However, before getting into these macro-economic forces, let's review some key historical information—the industry's micro-economic variables—based on data from CREST (Consumer Reports on Eating Share Trends) from the winter of 1978 through the fall of 1980.

Micro-economic variables

Sales—Until the summer of 1979, the industry had enjoyed several quarters of health sales growth in nominal dollars, including successive 16 percent increases from the summer of '78 through the winter of '79 (see figure 1). However, in the summer of 1979, dollar sales growth dropped to 1.7 percent, and except for a "strong" winter '80 (an

aberration resulting from a mild versus an extremely severe prior winter), the industry's sales growth remained weak until the fall of '80 when it posted a reasonably strong gain of almost 10 percent. Indeed, this upturn in the last quarter of 1980 may signal a potential turnaround for the industry.

Traffic—In measuring industry performance, it is important to understand that there are two major components of sales: *traffic* and *average check size* per eater. (See figure 2.) When we look at the recent sales history, we see that from the spring of '79 through the summer of '80 customer traffic showed negative growth except for the winter of '80 (an aberration). Generally speaking, traffic increases signify real growth for the industry while check size increases signify menu price inflation.

Now let's focus on the fall of '80 and understand some of the developments during that quarter which lead us to believe that we may have turned the corner on the recession.

Reach—In analyzing traffic, we see it has three major components: number of families reached; visit frequency; and average party size. During the fall of '80, Reach increased 2.5 percent, representing the strongest increase in this key component of traffic over the last 10 quarters. Simply put, 2.5 percent more families were attracted back into the marketplace during the fall quarter to make at least one restaurant purchase. Frequency (how often families eat out) for this quarter was negative (−1 percent) as it has been for the last six quarters, and party size continued to show relatively flat growth.

Dealing—We believe that the dramatic rise in the incidence of dealing during the fall of '80 was a key force in attracting customers back into the marketplace. Dealing hit a record high—with nine percent of all meal/snack occasions involving a deal—up 17 percent over fall '79. In particular, couponing accounted for 55 percent of all perceived dealing during this quarter—and that too represented a record high for the industry.

While dealing has clearly contributed to the consumer's improved price-value perception of restaurant meals/snacks, this development has serious consequences for unit P&Ls. In the past, dealing for most chains has been a device to develop Reach (new trial). However, it appears that dealing for some chains has become a primary marketing technique to maintain Frequency by offering a "permanent" discounted menu value. While generating short-term gains, the development of a 'deal mentality' in the long run could cause the industry more harm than good.

Supper—In the fall of '80, supper as a meal occasion staged a strong come-back, with traffic up 3.2 percent over the prior year. Specifically, supper accounted for 42 percent of all meal/snack traffic and 54 percent of all dollar sales during the quarter.

It is significant that deal use in terms of meal/snack occasions was the highest at supper. Six out of 10 deals involved supper. This improvement in supper when viewed in conjunction with the improvement in the fast food/family restaurant categories indicates a definite trading-down has occurred at this meal occasion.

Also, in terms of customer traffic by meal occasion, it is interesting that breakfast continued its growth in the fall of '80 as it has for the past several quarters, while lunch continued to show declines in customer traffic, and snacks—a barometer of the soft economy—exhibited a one-quarter increase in traffic, after several quarters of decline.

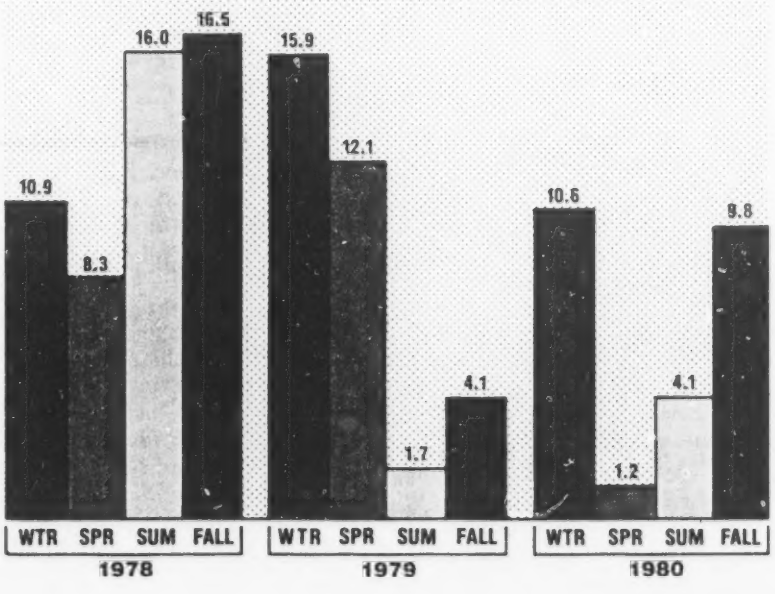
Take-out—The fall of '80 was the

"The industry's sales growth remained weak from the spring of '79 until the fall of '80 when it posted a reasonably strong gain which may indicate a turnaround."—**George Rice**

Total Industry Quarterly Dollar Sales Trend
% Change to Prior Year

Figure 1

Source: CREST Marketing Services 3'81



first of seven quarters reflecting a gain in take-out versus eat-in sales. Take-out sales accounted for 31.6 percent of total industry sales versus 30.6 percent in the fall of '79. As we will see later when we discuss the macro-economic variables, the decline and increase in take-out sales closely corresponds with changes in vehicle usage.

Chains—The top 150 chains tracked by CREST increased their market share by three percentage points to 41 percent of total industry dollars as measured over a four-quarter period ending in the fall of '80. This is up from their 38 percent market share for the four-quarter period ending in the summer of '80.

The chains, particularly in the fast food and family restaurant categories, showed real strength in customer traffic in the fall of '80. Fast food restaurants posted a 2.3 percent increase and family restaurants showed a 4.7 percent increase in customer traffic, while atmosphere/specialty restaurants suffered a 3.9 percent decline in traffic.

The chains were the first to be hurt by the recession and now they appear to be leading the recovery. The upscale restaurants were least affected at the beginning of the economic downturn. Their customer traffic held strong for two-to-three quarters as their higher-income customers base was insulated from the drop in real disposable income.

However, as the recession moved on, the higher-income customers while maintaining their frequency of eating out began to trade down. This is consistent with the increased share of supper occasions by the fast food and family restaurants. During the recession, a portion of the lower income people bailed out of all elements of the market. They really had to change their behavior and eat out less often.

Macro-economic variables

Over time, we have developed a greater understanding of the shifts in the U.S. economy and how they impact on the foodservice industry. In late 1979, CREST Marketing Service and Chase Econometrics joined forces to develop the CREST/Chase Foodservice Industry Forecast. Through this joint venture, we have identified four major macro-economic variables that explain variations in consumer eating-out behavior as tracked by CREST.

Through a sophisticated statistical modeling approach, we can forecast the future of the industry over the short and long term.

While we will consider each of

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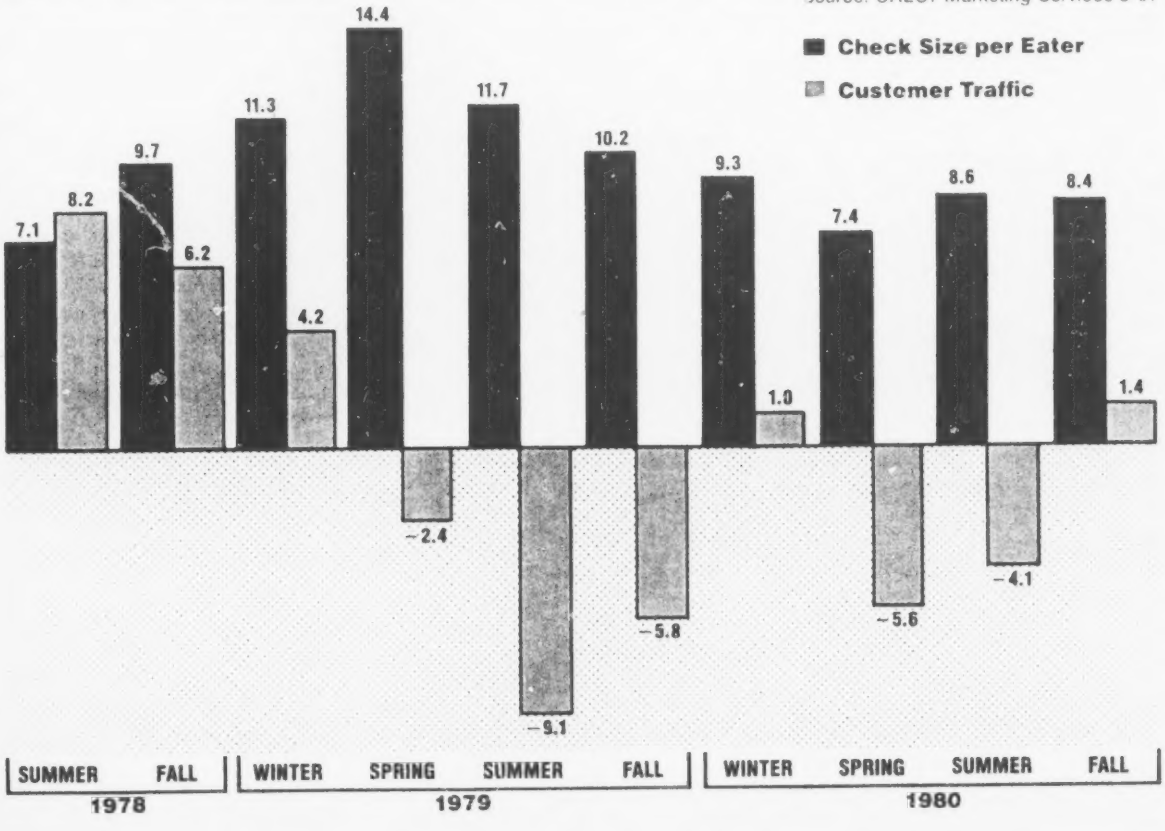
Components of Sales
Check Size and Customer Traffic (% Change to Prior Year)

Figure 2

Source: CREST Marketing Services 3 81



During break, (l. to r.) Daniel, Cooper, Rice and Lee continue discussion while Laughery (far l.) looks on.

James Harris
Vice President, Specialized Industries

Citibank, N.A.

In terms of how we at Citibank view the economy, I would like to focus on three key elements that have been critical in the development of our economy since World War II, namely: cheap energy, cheap money, and an adequate supply of willing workers in the population.

At Citibank, we look at these as being in a state of flux for the next 10 to 20 years.

Energy, of course, is the issue foremost in our minds today. I can tell you, our economists predict that by 1985 the average per barrel price of crude oil will be $54 (up 74% over '80) as opposed to $31 (up 182% over '75) at the end of 1980, compared to the $11 dollar price per barrel in 1975. If we translate that into the pump price of a gallon of gasoline these increases will mean that you and your customers will be paying, $1.95 (up 61% over '80) per gallon for regular gasoline in 1985, as opposed to an average of $1.21 (up 112% over 1975) at the end of 1980 and 57 cents in 1975. As in the case of most predictions, the assumptions used in making these predictions are extremely important.

> "The restaurant business today is properly characterized as a mature business. Unfortunately, the word mature is often taken to mean lack of opportunity. In my opinion, nothing could be further from the truth. What we are looking at today is a change in trends, and not an apocalypse."
> **—James Harris**

First, we look at the situation in the Mideast today which is extremely volatile. We have a war between Iraq and Iran that is likely to continue for some time. This will disturb the supply of oil considerably over the next five years. It already has had an adverse effect today.

Second, we must also look at the total demand for oil, which currently exceeds output. Although demand is declining, we still will have a long-term trend in which total demand exceeds total output. There is nothing in our analysis to indicate the situation is going to get better instead of worse. In fact, I think you might say that more things can go wrong with this scenerio than right.

In applying this scenario to the restaurant business, two significant conclusions become apparent.

First, as energy costs continue to escalate, it seems to me that consumers will continue to alter their spending patterns in accordance with their perceptions of future economic conditions as well as their particular economic circumstances. For restaurateurs, this latter point seems to me to be particularly important. Since World War II, the percentage of disposable income spent on food has not changed all that much. *Where* that money is spent, however, has changed dramatically, and I would think this issue will continue to be an issue that is near and dear to each of your hearts for some time to come. In my opinion, I would think that the rate of growth in the number of meals eaten away from home is likely to decline over the next 10 years. Continued inflation of energy costs is but one of the major concerns of restaurateurs.

The second concern (or conclusion) is the disappearance of cheap money. I was told but have not checked it out myself before coming down here, that if you had purchased every corporate bond that's been issued since 1946, you would have lost money in *real* terms after adjusting for inflation. Abraham Lincoln once said: "You can fool all of the people some of the time and some of the people all of the time, but you can't fool all of the people all of the time." Expressed another way, don't try to sell a 30-year fixed-rate bond in today's bond market. It seems to me this will have far reaching implications for future development of restaurant chains and retailers in general.

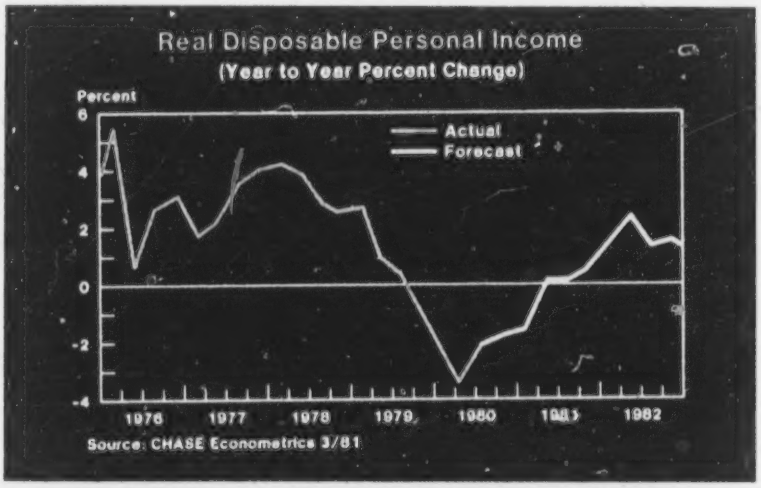
If a key financial measurement of growth is earnings per share, then the cost of borrowing money becomes extremely important. Moreover, it's particularly important when looking at new projects, and how you evaluate these additional investments. I will say point blank there is no restaurant today and there is no retailing business today that can support a 20 percent interest rate. It just can't be done. Although there are other methods for evaluating potential investments such as discounted cash flow, internal rate of return, you still come back to very fundamental questions as they relate to financial strategies.

Although there is plenty of money around today, the rates are truly staggering. I doubt that many restaurants could be built today that would generate sufficient cash flow to pay interest at 15 or 17 percent and amortize principal within seven years.

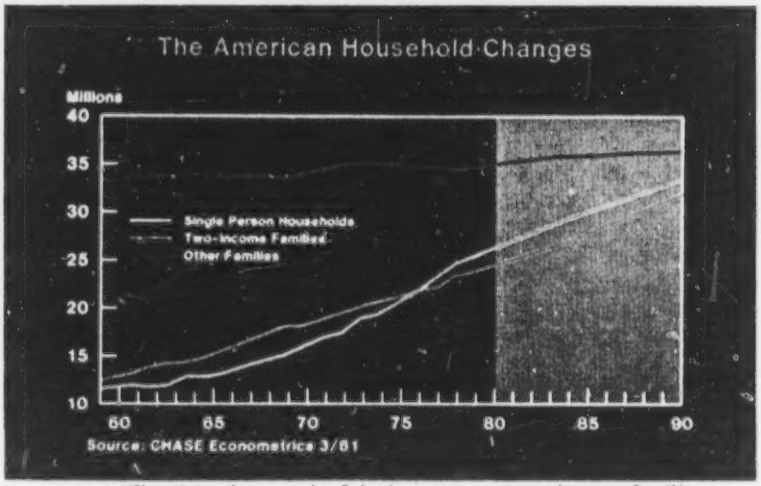
I also doubt that many of you would be considering major expansion programs if you knew today that your 30-year money was going to cost you 15 percent during the first 5 years, 20 percent for the second five, 30 percent for the third five and 35 percent for the last five.

The problem, of course, is that gains on a comparable basis are hard to come by. For general merchandise retailers, the rule of thumb is eight to nine percent comparable store growth and I suspect this would hold true for restaurants as well. However, general merchandise retailers have shown a remarkable ability to manage their margins more effectively to keep these gains up. Sourcing apparel items overseas has kept many a retailer competitive. Restaurants do not have this flexibility.

The final area that we watch is labor. I'm sure each of you have had the dubious distinction of awarding your employees an across the board eight percent salary in-



(Fig. 3) Real growth in the industry is driven by changes in DPI. . .



and (Fig. 4) by the growth of single-person and two-income families.

crease effective the first of the year. Of course, no one from the government came around to guarantee you an eight percent increase in productivity, but that's the way these things tend to go these days (See figure 14.)

How you cope with this seems to me to be fairly simple. You either raise your prices, or you reduce the permanent labor force you employ. Not by firing anyone, but certainly you slow down replacements.

I would like to think the new Administration and Congress—and a presumably more conservative Administration and Congress—will act to take these problems off your back. If not, we are going to see continued problems in terms of productivity and maintaining quality of service in the restaurant business. I think a critical issue in terms of labor would be the ability to continually reduce the size of your work force and still maintain quality of service. Maybe there are some technologies that will enable work to be performed mechanically.

You may see voice-activated computers controlling the entire processing of food for the consumer some day. Who knows, maybe the automat will triumphantly return to the scene.

I do have some projections on interest rates, and I will pass them along provided you promise not to rely on them (See figure 15.)

This year I see the prime rate moving down and moving down substantially. Our economists tell me that they expect the prime rate to move down into the 12 to 14 percent area. In our view, the economy is in a downward trend that will continue into 1982. We see the prime moving under ten percent by then. By 1983, we'll see the economy beginning to move up with rates in the 10-12 percent range. In turn, this trend is likely to continue through 1984 with the prime rate moving to around 13-14 percent and thereafter settling back to a 12-13 percent level in 1985.

In looking at these predictions, I would add a cautionary note. In the past two years, there was a profound, and I mean profound, change in the financial market place. The old rules under which these predictions were made appear to be changing very rapidly.

Let me try to explain what I mean. Over the past six to 12 months we see what appears to be an anomaly in the financial markets. Traditionally, interest rates have followed the predictable laws of supply and demand. When the supply of money constricted, rates shot up. Conversely, when the supply of money increased, rates declined. Today, we see interest rates behaving more like pork belly futures than interest rates. If supply goes up, so do rates over the short term. The explanation for this is that the market place is anticipating future courses of action that the regulators may take to bring monetary growth back into line.

Over time, I would hope that the Federal Reserve Board demonstrates an ability to control these monetary aggregates.

Since I don't want to present too much doom and gloom, let me sum up by saying that the restaurant business today is properly characterized as a mature business. Unfortunately, the word mature is often taken to mean lack of opportunity. In my opinion, nothing could be further from the truth.

What we are looking at today is a change in trends, and not an apocalypse. The smart operator will understand this and proceed accordingly. The less sophisticated operator won't, and he'll be in trouble within a few years.

> "Under a sale/leaseback program, the franchisee will generally find that his lease payments will be 1½ to 2 percent lower than his current cost of debt."—**Frankel**

Barksdale, Harris, Lee

Ray Daniel, Chase Econometrics

Farquharson, Capoor

Frankel, Cooper

Nancy Frankel

Regional Vice President

Integrated Resources, Inc.

I wish to discuss alternative sources of financing whereby a medium to large size company (with a net worth of at least $30 million) can use its fixed assets and convert them into cash by means of a sale/leaseback program of its real estate.

Historically, the restaurant in-

dustry, and in particular the fast food business, has had such an impressive growth rate that it had many forms of financing available to it. Such avenues have included: the stock market (new issues) and the debt market (company bonds and bank loans).

However, now we have seen a weakening in the equity markets as the hyper growth of the fast food chains is cooling off. And the debt market is much harder to support today with double-digit interest rates.

The difficulty in financing new unit structures is even more serious for franchisees who usually don't have the same kind of credit line as their franchisors.

The options

There are two sale/leaseback avenues available to restaurant chains wishing to raise capital. They include:

- The sale/leaseback of an existing facility or a planned facility to a limited partnership of *private investors*. The lease package can include land, building and equipment, or some combination of the three. The investors benefit from current income tax write-offs, subsequent cash flow, and long-term appreciation of the real estate. And the restaurant operator benefits from the capital that flows to him from the investors.
- The sale/leaseback of a facility to a limited partnership of *public investors*. Conceptually, the public investment programs are similar to the private placements. However, they do differ in their specific structure.

Private offerings do not have to be registered with the Securities and Exchange Commission while public offerings do.

And unlike private placements, which are tailored to the needs of the wealthy individual able to make a substantial investment, the public partnerships are tailored to the needs of a much larger spectrum of the population who have a more modest amount to invest.

Sale/leaseback investment programs have been in existence for many years; however, their use by restaurant companies to raise capital has grown significantly in the last five years.

Integrated Resources' public funds, including American Property Investors, to date have raised over $390 million of investors' equity. This pot of money has been invested in a portfolio of different real estate properties and include several restaurant companies: Gino's, Bonanza, Ponderosa, Victoria Station, Collins Foods, and W.R. Grace.

Until recently, these limited partnership programs have invested in a diversified portfolio of retail businesses. Now, publicly offered partnerships are also being formed to raise a fund of money for a particular franchise system, including restaurant franchises. This is the most recent development in sale/leaseback investment programs.

These public funds of money directed to a particular franchise system provide restaurant franchisees with a new entrance to the capital markets and provide the partnerships a new investment vehicle.

The individual investor can expect to earn a return on his invested capital of 8 to 10 percent. This return is extremely attractive to the medium-size investor—unable to participate in the municipal bond market or other investments requiring larger amounts of money. His minimum investment can be as low as $2,500. In addition, he benefits from the preservation of capital, equity build-up, and capital gain through the appreciation of the real estate.

The restaurant chains benefit by obtaining a new source of money to finance their unit expansion. And public companies experience improved earnings per share since lease payments are usually less of a hit to earnings than debt service payments.

In addition, the franchisee will generally find that his cost of funds with lease payments will be 1.5 to 2 percent lower than his current cost of debt. The franchisee also has the option to buy back his facility and equipment at the end of the term.

The risk and return on each investment will determine the specific rate set.

Such programs demonstrate that the financial community is not locked into a tradtional way of doing business. It can be creative and aggresive in developing alternate avenues of capital formation for the business community. As market needs change, so will the products being supplied change.

Berlind, Berlinski, Capoor, Bakos

Rosenberg, Daniel, Emerson, Laughery

(See page 178)

Ray Daniel
Vice President-Agricultural Economics
Chase Econometrics

Throughout the 1980s, food will no longer be the bargain in real terms that it was for the American consumer during the 1960s and 1970s. During the 1980s, we expect food prices at least to keep pace with the overall inflation rate, and we may come to accept a 9 to 10 percent inflation rate for food as normal during the first half of the decade.

On a short-term basis, we expect the inflation rate for food to climb even higher than the norm. As the recession ends, demand for red meat will pick up again. However, last year's drought brought meat and grain inventories down to record low levels. As a result we see the Consumer Price Index for food-at-home increasing 12 to 13 percent and the CPI for food-away-from-home increasing 13 to 14 percent in 1981. Next year, we are forecasting an 8 to 9 percent increase in at-home food prices versus a 10 to 11 percent increase in food-away-from home-prices.

However, there are a number of macro-economic forces which could change next year's forecast for the worse. For example, another drought could create a big shortage of grain in 1982 and drive up food prices even higher. If the rate of inflation does not show signs of slowing by the end of the year, the Federal Reserve Board is likely to boost interest rates which will put us into another recession. Also, all bets are off if we are hit with another severe curtailment in oil supplies as we were in early 1979.

Meat overview

Over the past 30 years, total meat consumption per person has increased by 2.8 percent annually. Beef consumption per person increased by 2.6 percent, poultry consumption increased by almost 3 percent, while pork consumption declined 0.4 percent annually over this period. (See figure 12.)

However, during the decade of the 1970s, per capita consumption of beef appears to have hit its peak in 1976. Since then, it has declined steadily. And in 1980 per capita beef consumption fell to 1967 levels, while pork consumption returned to 1975 levels—after four years of moderate increases. Only per capita consumption of poultry continued to remain strong.

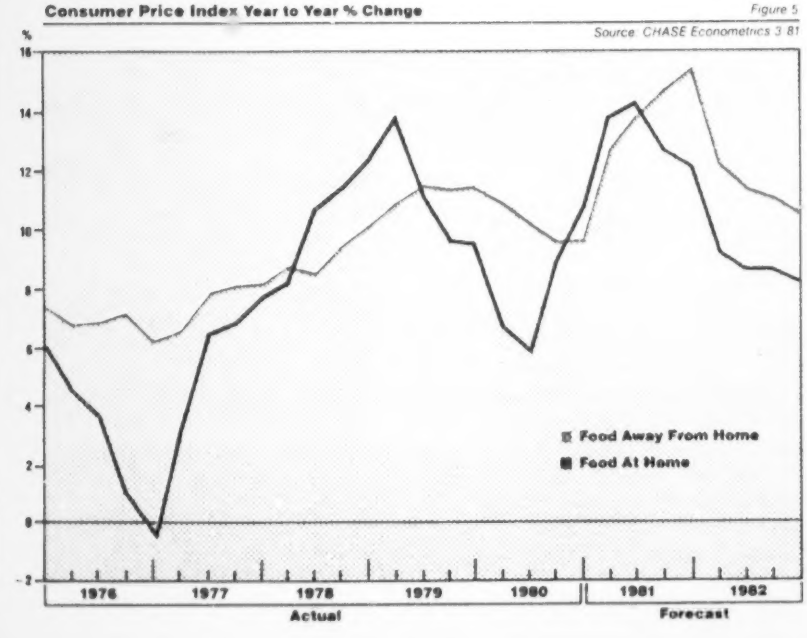
Poor profitability in the livestock industry due to weakening demand in the 1974 and 1980 recessions and high feed costs have been major factors contributing to collapses in animal numbers. And the biological nature of the U.S. livestock industry prevents farmers from responding immediately to changes in consumer demand. When farmers liquidate their cattle herd as they have been doing since 1975, it takes five to six years before farmers can bring cattle numbers back to their previous peak levels. The cattle cycle is thus 10 years in length from peak to peak.

In the pork industry, it takes three to four years to rebuild the herd following a liquidation. On the other hand, the poultry industry can respond to increases in consumer demand within six to eight weeks.

The beef industry has currently bottomed out and farmers are slowly beginning the rebuilding of our cattle herd which has experienced the largest liquidation in U.S. history. Poor profitability in the hog industry in 1980 is now expected to curtail pork supplies by six to eight percent this year, while high grain prices hold poultry supplies at a one to two percent increase in 1981.

The next five years are subsequently expected to be a period of higher beef supplies and relatively flat pork supplies, while poultry supplies should increase between 2.5 and 3.5 percent annually.

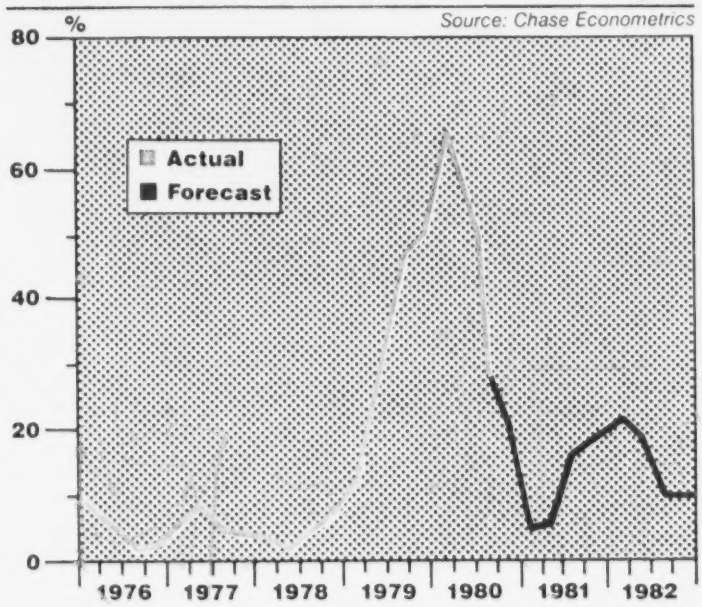
"The next five years are expected to be a period of higher beef supplies and relatively flat pork supplies, while poultry supplies should continue to increase $2\frac{1}{2}$-$3\frac{1}{2}$ percent annually."—**Ray Daniel**



"Increases in our real disposable income will translate into greater reliance on food-away-from-home."—**Ray Daniel**

Consumer Price Index Gasoline *Figure 6*

Source: Chase Econometrics



Price outlook

Increased demand and the current low herd size will force up the price of beef 20 to 30 percent between now and the end of 1982. In addition, higher feed costs to producers and a drop in supplies of competing meat, especially pork, will put upward pressure on beef prices. (See figure 8.)

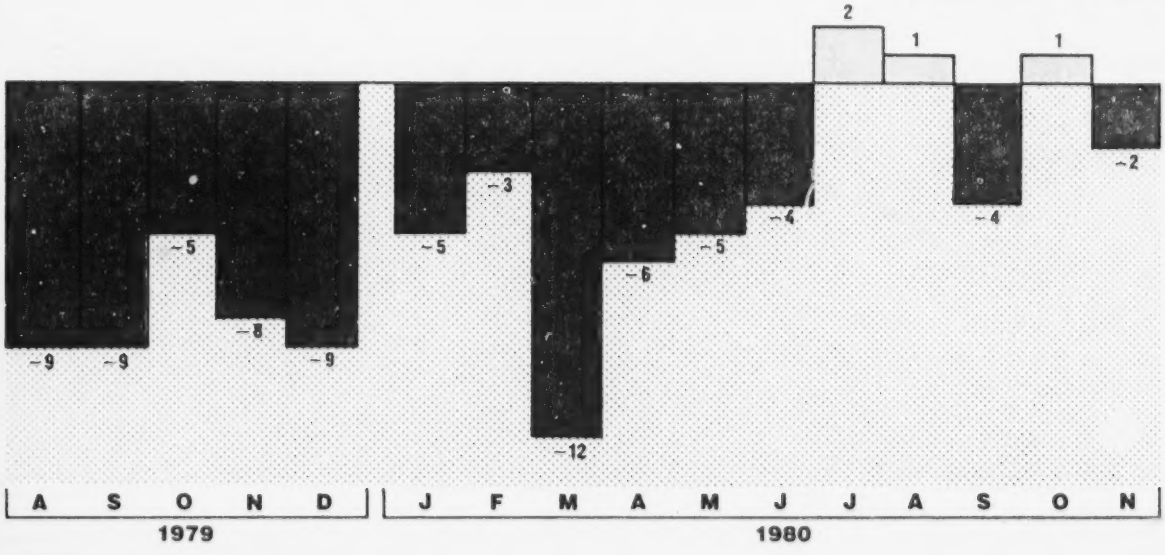
This year grain prices are expected to increase 21 percent over 1980 levels. And if we are hit with another severe drought in the growing regions, grain prices will climb even higher—impacting on fed-beef supplies and prices.

Pork prices will also increase significantly this year due to curtailment in production. We expect the wholesale price of pork to climb 34 percent over its 1980 price, thus dampening demand. (See figure 9.)

In fact, over the past several years, there basically has been no growth in the pork industry. In my opinion, the reason this industry has remained relatively flat, is that pork is not a big menu item in restaurants. The challenge then to the pork industry is to work with the restaurant chains in developing menu programs that utilize this red

Trend in Miles Driven per Family* Total US
% Change vs. Year Ago *Figure 7*

**NPD Gasoline Market Index*



meat item and make it more attractive to the dining-out consumer. In its favor, pork historically does not fluctuate in price as greatly as beef and its wholesale price is lower than beef. Last year, pork at the wholesale level was 26 cents per pound cheaper than beef, and this year pork will average about 20 cents per pound less than beef.

Broiler prices are also expected to increase this year as the economy expands and supplies of pork decline. Overall, broiler prices are expected to increase 15 percent in 1981, versus a 5 percent gain in 1980. (See figure 10.)

Long-term outlook

As noted at the outset, food has represented a real bargain for Americans during the past several years in comparison to the increasing costs of other goods and services. Since the end of World War II the percent of disposable personal income spent on food has declined steadily—from 26 percent of DPI in 1947 to about 17 percent in 1979.

> "Lifestyle trends indicate that Americans will not only increase the quantity of their dining-out occasions, but also the quality of these experiences."—**Ray Daniel**

During this period, the percent of DPI spent on food-away-from-home has held fairly steady at around four percent, while disposable personal income has increased over 850 percent in nominal dollars. (See figure 13.)

It is important to realize that this decline in personal expenditures for food in relation to disposable income is not the result of Americans cutting back on their food purchases. Rather it signifies the fact that food prices have not kept up with the overall rate of inflation—except for a short period in 1973-1974 when there was a worldwide drought and food prices climbed faster than the overall rate.

However, given the low profitability of farmers today, the increasing worldwide demand for food, and rising farming costs, we expect the percent of disposable income spent on food will turn upward again during the 1980s or at least stay at its present level.

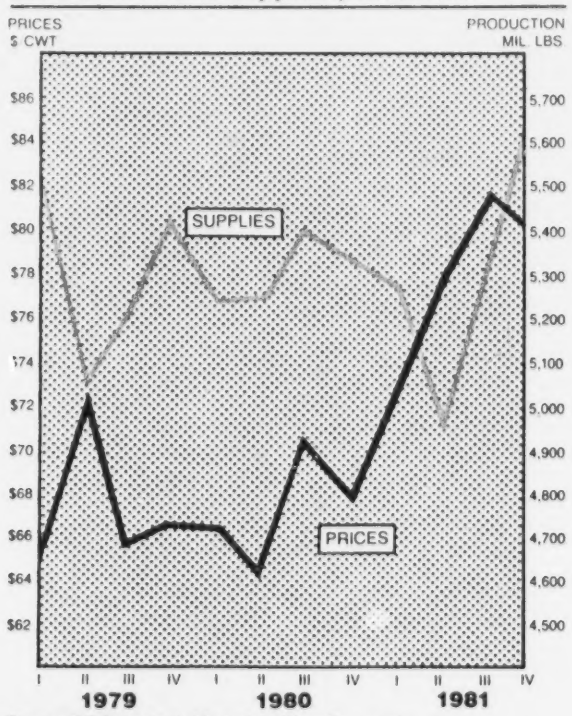
As food inflation reaches parity with or exceeds the overall rate of inflation, Americans will be forced to spend more of their disposable income on food.

This scenario, of course, assumes that our economy will continue to grow—resulting in real gains in our disposable income. We expect real disposable income to increase between 2.5 and 2.8 percent annually during the next five years. As our real disposable income increases, we will want to increase our standard of living—which will translate into greater reliance on food-away-from-home.

The current drop in per capita consumption of beef, for instance, is

Figure 8

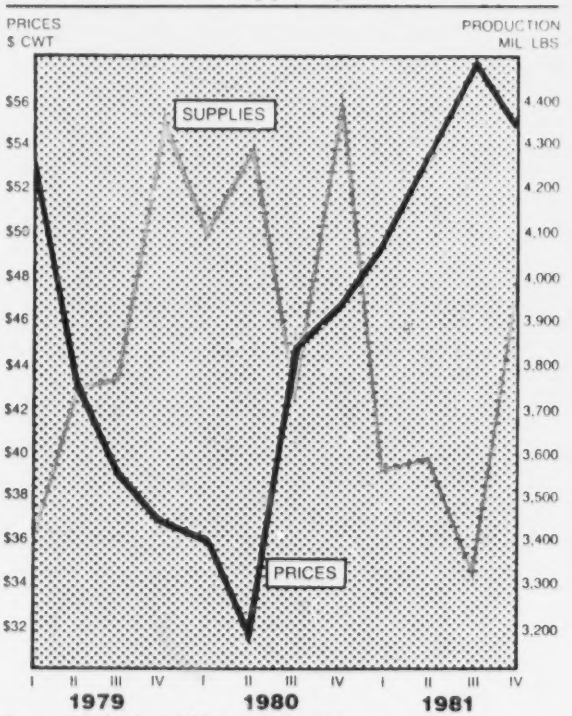
Beef Prices and Supplies, 1979-1981



Sources: U.S. Department of Agriculture, Chase Econometrics

Figure 9

Pork Prices and Supplies, 1979-1981



Sources: U.S. Department of Agriculture, Chase Econometrics

a result of the cyclical change in beef supplies and a drop in real disposable income which has reduced consumer purchasing power. We don't believe that Americans are losing their appetite for beef. In fact, we expect per capita consumption of beef which has dropped to 106 pounds (carcass weight) in 1980—from a peak of 133 pounds per person in 1976—to turn upwards in the 1980s and may well reach 117 pounds per person by 1985.

Of course, it is possible to paint a different scenario—one in which our disposable income encounters a sustained period of no growth or even decline. In this event, Americans would likely reduce the quality and quantity of the foods they consume—for instance, eat more grain and less beef—and possibly change where they consume food—at home versus away-from-home. But I for one don't buy that scenario. The income of Americans will grow in the 1980s—although at a more moderate rate than in the 1970s.

Harris Cooper

President

International Dairy Queen, Inc.

The industry as a whole must be most sensitive to dwindling consumer spendable income and the level of available capital at reasonable rates for new store development and for modernization, conversion, and refurbishing programs.

In the Dairy Queen system, we are experiencing continued customer growth in this soft economy, as we have during past recessions. Thus, the economic downturn has not presented any special problems for us. Although the high interest rates have curtailed *some* development programs, we will easily meet our internal growth plan in this area. We are still admitting into the D.Q. system qualified prospective franchisees. The remodeling of our stores under the "ICAN" program did suffer to a modest amount as a result of high interest rates, but not enough to seriously retard this area of our endeavor.

While the industry in general has had its ups and downs in terms of customer count, check size, volume, etc., our D.Q. programs are continuing at full strength. The "It's A Real Treat" campaign for the D.Q. products and the "More Burger than Bun" campaign for our Brazier food products continue to be successful, supplemented in 1981 by the "Full Meal Deal" campaign, a concept of meal versus ala carte packaging for the fast food industry, and our new introduction—the "Hot Doggity Meal" kids program.

Our current programs were strong enough to produce a "black ink" first quarter for 1981—the first time the winter period showed positive results in IDQ's corporate history.

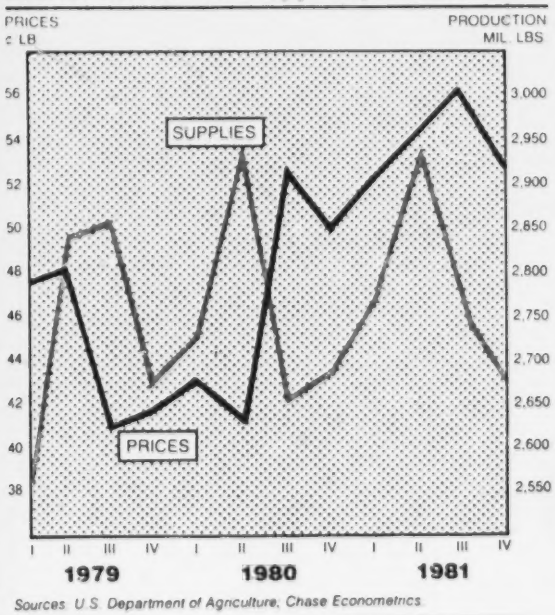
Factors of success

The D.Q. system's success has been governed by two principles: the continued and valued success of

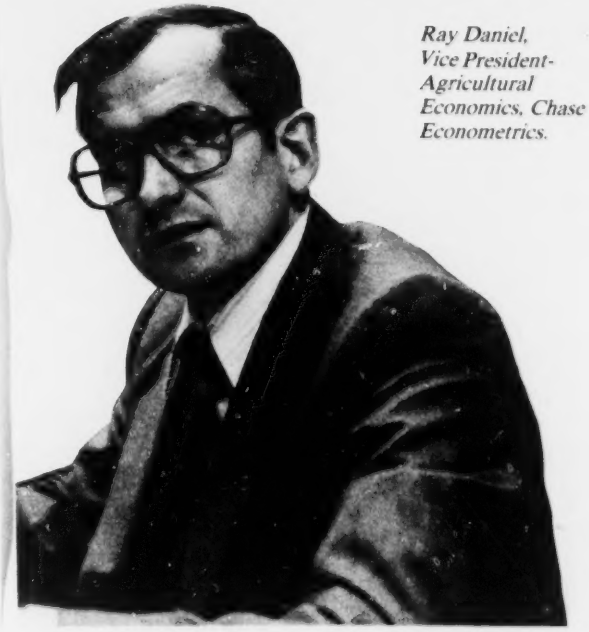
"Managers think of us as ogres because we neither understand their needs nor deal with their thoughts and problems."—**Harris Cooper**

Figure 10

Broiler Prices and Supplies, 1979-1981



Sources: U.S. Department of Agriculture; Chase Econometrics



Ray Daniel, Vice President-Agricultural Economics, Chase Econometrics.

Harris (l.) tells Lee and others his prime rate forecast.

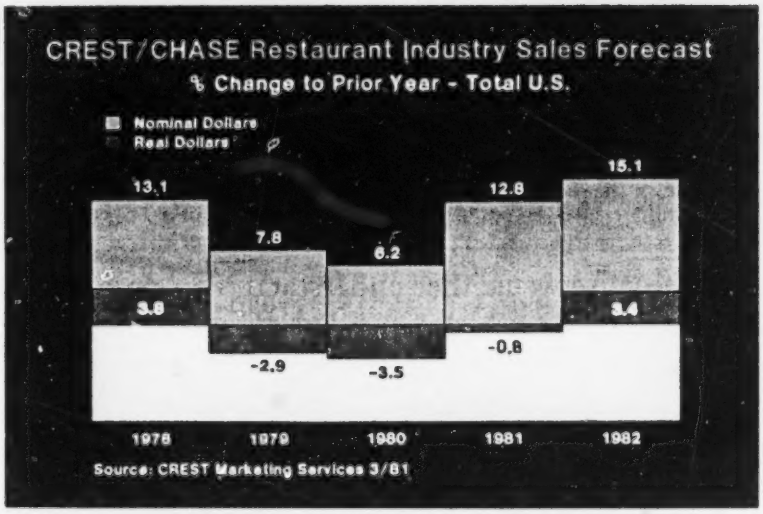


Figure 11

the 4,800 units that have been built, and the ongoing programs that permit 120 to 200 new Dairy Queen or Dairy Queen/Brazier franchisees to become members of our system annually, with continued profitability for the past franchisees as well as the newcomer.

Our principal concerns have been the continued success of our existing franchisees, rather than an emphasis on how many new units can be opened annually on a helter-skelter basis. The attentiveness to this principal has provided us with the synergism that was necessary not only to turn around our system, but also to continue its success after the turnaround.

Management

Top managers in our industry neither appreciate the opportunity they have nor maximize it. Many of them are currently mired down in "What can you do for me?" instead of "What can I contribute and thus receive reward for." Restaurants do not compete on management policies; they compete on the success of their employees.

The key vulnerability of the industry at this time is our inability to attract the manager who can come away from our experience feeling that he or she is a better, knowledgeable, competent, developed person. This is sad; but it is true. Here we have failed. Managers think of us in this industry as ogres, basically because we neither understand their needs nor have the capability of dealing with their thoughts and problems.

Some thought might be given to utilizing key employees with good leadership skills to help train the crew. This would give me freedom to the store manager. The idea that better equipment will replace people is a gross exaggeration since, as in the computer field, there is still truth to the maxim: "Garbage in, garbage out." It is still a people business.

The question that must be answered is: "How are we going to create a positive image for our industry, thus allowing more people to take advantage of an excellent management opportunity with high income potential?

Management strategy

New strategies will be necessary for all.

The first element of the new strategy must focus on providing the consumer with a pleasant experience. Quality, value, service, and cleanliness must be maintained and dressed in new vehicles.

The second element should focus on the people who make it happen—the employees. New vehicles must be designed to make a career in foodservice more attractive to them.

The third element is marketing. New approaches must be developed to entice the trier or trier/rejector away from a competitor, as well as to increase the number of medium and heavy users of our product. The fourth element is, of course, capital. It seems that capital is readily available for a good venture. Sometimes it may be costly, and too costly for the moment, but patience has generally brought a reduced borrowing market. And thus the opportunity that had been sought can become a reality.

Jack Laughery

President

Hardee's Food Systems, Inc.

If I can go back and trace what major success Hardee's has had, I would attribute 90 percent of it to long-range planning. We sat down to do our long-range planning in 1973. Since that time, we have made it very much a group activity. Everybody—from the director level and up—participates in our long-range planning activities. We've been very successful in our planning process because we have broken it down into very small segments.

It's sometimes depressing and discouraging to realize the many factors over which we have little or no control, but which have such a tremendous effect on our business. Yet, when you break the problems down into smaller ones—for example, asking each director: What are you going to accomplish by a specific date?—you bring down the task to a manageable situation.

There has been a significant change in strategic emphasis at Hardee's: We have shifted from being a predominantly operations-oriented company to being a marketing-oriented company. Marketing is now at least on an equal footing with operations if not more so.

As regards research and development, I can recall in 1973, Hardee's total R&D budget was around $30,000 to $40,000. It really wasn't product development at all.

Today, we'll spend in the neighborhood of $1 million or more. We do obtain outside research. We also obtain studies by outside sources concerning our advertising effectiveness. We would agree with Harris Cooper that research is undoubtedly more easily accepted by the franchisee when conducted by independent consultants. However, we do a considerable amount of internal research which involves improving existing products as well as developing new products.

Fortunately, the first new product we brought out, some four years ago, was a roast beef sandwich that had very good immediate success. Most of our growth, in fact, has come from new products. Through the combination of our internal research and development identifying new products desired by our consumers, and the aggressive product development of our franchisees based on their own research, we have been able to introduce a number of extremely successful menu items.

As discussed earlier many foodservice companies have succumbed to overbuilding. We back into the number of units we build. We have stuck fairly well to our expansion formula during the past five years. I think we develop our new-unit targets in an unusual way. In our first long-range-planning sessions, we asked: How many stores can we realistically build. Of course, we came up with a very ambitious expansion plan. But we examined it and took

Rosenberg (l.) and Laughery (center) tell Emerson the reason for their optimism during a coffee break.

a step back. We established a long-range plan that called for a 15 percent compounded increase in units over the next five years.

Rather than the availability of capital dictating our expansion rate, we decided that the rate of expansion should be dictated by the number of trained managers and personnel we could produce internally. The reason for doing this was the lack of quality trained people. The basic assumption we made was: We'll recruit our normal turnover. We'll develop the personnel internally.

Instead of letting the financial people determine our rate of growth, we focused on operations. We said we wanted to hear from our operations managers and training managers. They determined how many additional management teams could be developed per year. And that's how we got back to an effective, feasible growth rate.

I am very positive about the opportunities for us in the 1980s, because basically I'm optimistic. I think we will keep pace with the changing needs and the demands of the consumer and the market. Companies that emphasize marketing rather than strictly operations will succeed in the '80s."

"Instead of letting the financial people determine our growth rate, we focused on operations. We wanted to hear from our operations managers and training managers. They determined how many additional management teams could be developed per year."

—Jack Laughery

Robert M. Rosenberg

President

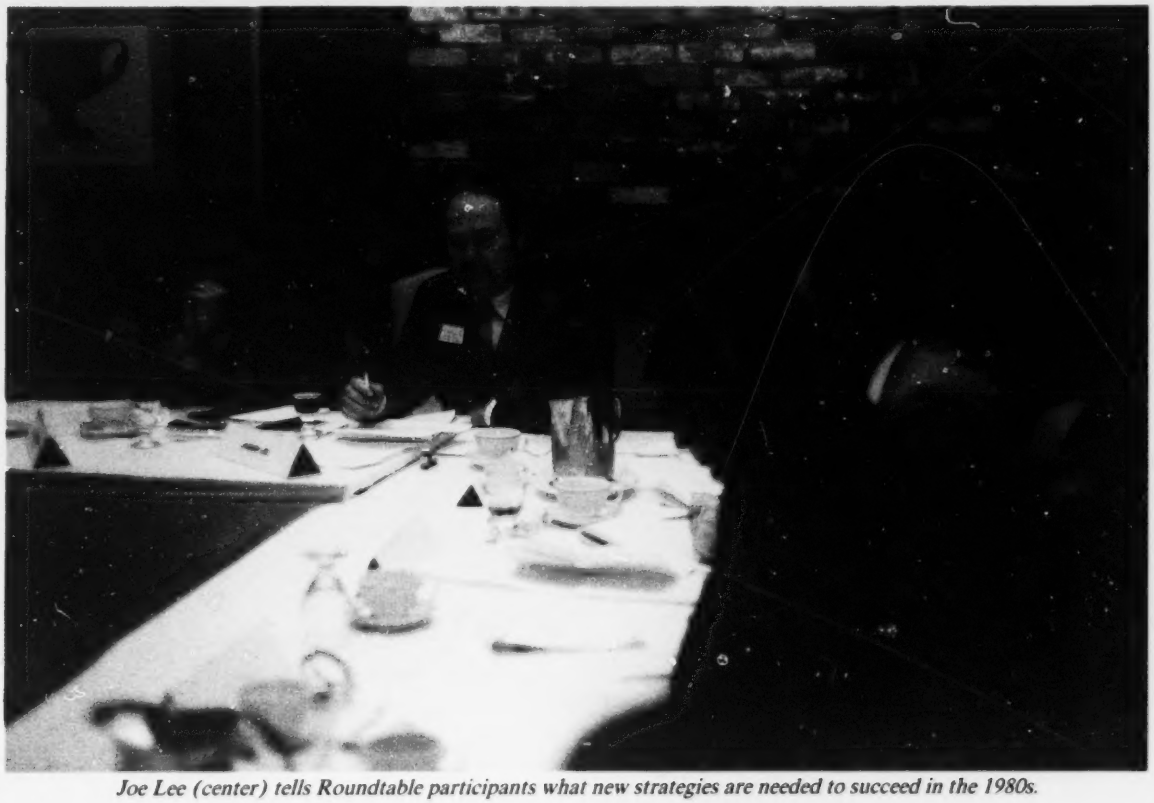
Dunkin' Donuts

What key factor or factors make for success in the foodservice business?

What policy or management style separates the winners from the "also rans" or from the outright "losers?"

My conclusion is that our $100 billion industry is too large, with too many firms at different stages of development, for one or two policies or one management style to spell the difference between success and failure.

Clearly, Pier 4 in Boston can be as successful proportionately by most financial yardsticks as McDonald's yet the policies and styles of the two operations could be a world apart. Yet, both could be equally effective.



Joe Lee (center) tells Roundtable participants what new strategies are needed to succeed in the 1980s.

Therefore, all that I am comfortable in commenting on are the factors that have made Dunkin' Donuts successful—many of which may be unique to the product, stage of development or personality of our company.

I would say the pursuit of three fundamental beliefs has accounted for our success over the last several years. These would be:

- The commitment to quality,
- The commitment to a particular planning process and,
- The commitment to a quality organization.

Let me touch on each of these briefly.

Commitment to quality

For certain concepts, convenience or price might be the controlling factor in their success. At Dunkin' Donuts, we feel quality is the critical ingredient. And over the years, we have committed ourselves to deliver the very best quality product available.

We believe that when you get right down to it, the reason for the staying power and preeminence of most food products is that they just plain taste delicious.

In our case, we are one of the few chains that still grind our coffee fresh from beans made to our formula. We use 18 percent cream in our coffee, we use the highest fruit content in our fillings, and the highest percentage of Dutch chocolate in our chocolate cake mix.

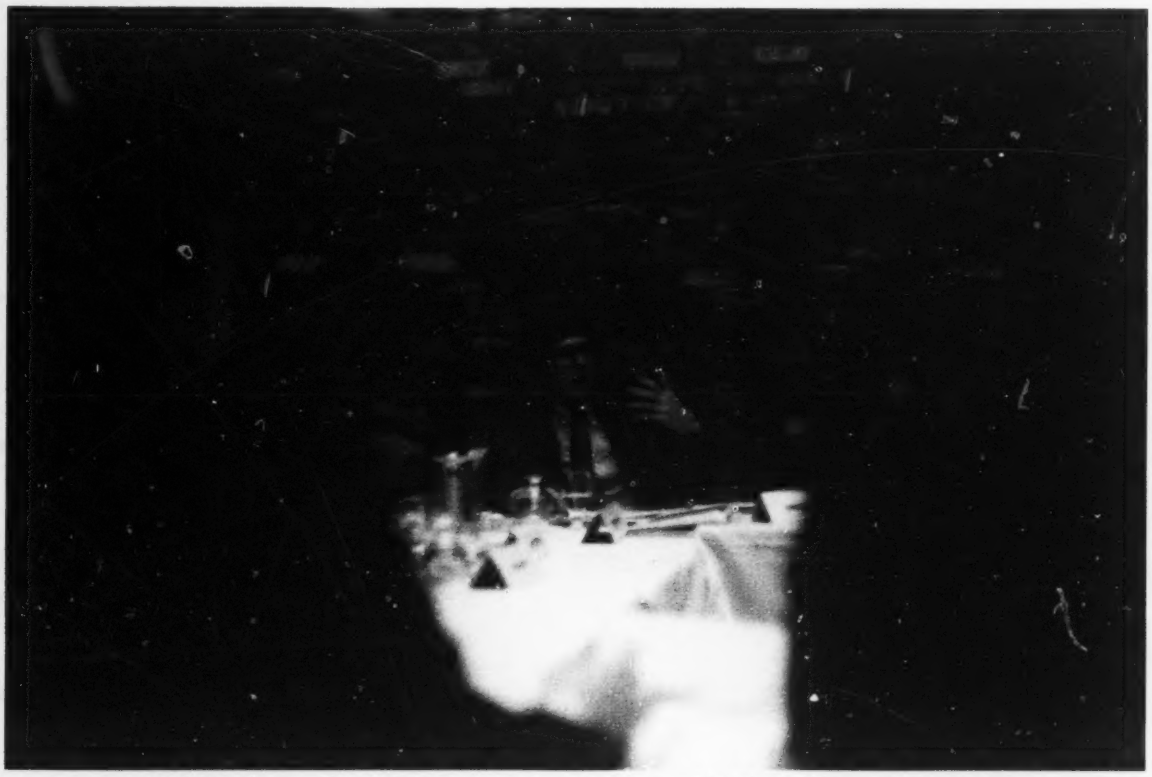
When we introduced muffins as a new product to our system, we became the world's largest buyer of native wild blueberries. That meant we had to establish a frozen food distribution network to complement our dry goods distribution and we had to bring freezers into our shops. If we used cultivated blueberries, we might have saved ourselves a good deal of trouble, but cultivated just aren't as good as the wild variety.

Our franchise owners share that commitment to quality and we feel it has been one of the cornerstones to our success.

Commitment to planning

For the last eight years, we have utilized a planning process which insures that we:

- First, continue to evaluate our resources and the environment and define our mission (or what kind of company we want to be). Conversely, we evaluate what we are not or can not do, at least for the present.
- Second, we have clear financial objectives that define what we want to achieve in terms of earnings per share, return on assets, growth in sales and units, etc.
- Third, we have a clear strategy that channels our resources toward the achievement of our objectives on a priority basis. By use of a computer, we have the ability to evaluate various strategies—both in terms of our balance sheet and our profit-and-loss statement by quarters over a five-year period.



Bob Rosenberg explains the three fundamental beliefs to which Dunkin' Donuts is committed.

Nancy Frankel (l.) and Jim Harris discuss the financial community's perception of the restaurant industry.

In Dunkin' Donuts' case, our mission—which sets the tone for what we will and will not do, and which casts a shadow over all our activities—is to be the preeminent worldwide retailer of donuts and compatible bakery and beverage products.

However, our mission, quite obviously, isn't appropriate for any other company. The important fact in our view is that a company must determine what is appropriate for it, stick to it and reevaluate it from time to time.

Another example, our strategy to achieve our objectives calls for us to expand our distribution, build productivity by increasing our advertising expenditures, remodel our shops, expand our menus and raise our operating standards.

Our strategy might not fit another company, but we feel we have done the thinking necessary to develop a focus plan that is relevant for us. And, we believe our continuing commitment to this planning process has been a key factor in our success.

> "For certain concepts, convenience or price might be the controlling factor in their success. At Dunkin' Donuts, we feel quality is the critical ingredient. And over the years, we have committed ourselves to deliver the very best quality product available."
>
> **—Bob Rosenberg**

Quality organization

Last but not least, we believe a great deal of our success these past years is our commitment to building and keeping a high-quality organization.

We are very proud of most of our franchise owners and our staff. One of my most gratifying accomplishments during my 17 years as president is the longevity we have in our staff. We are a young company. The 17 members of top management average 42 years old; and 12 years of service with the company.

There are 61 executives at our director level and above, and despite the fact that they are only 40 years old, on average, they have nine years of service with Dunkin' Donuts. I think those are very favorable statistics.

I believe it takes, not only exceptional people to build an exceptional company, it also takes continuity. I believe efficiency and confidence grow as length of service grows. As an indication of our staff's competence, there have been 32 promotions to director level and above at Dunkin' Donuts during the last three years. All but three of them, almost 90 percent of our promotions, went to people within our own organization.

I believe these results reflect a participatory style of management—where people can make a contribution and feel a strong sense of participation.

This philosophy, style and commitment reach beyond our immediate staff to the training, communicating and supervision in existence for our franchise owners and members of their staff. In addition, franchise owners actively participate in the development of operational policies and serve on task forces that seek to improve the system. Beyond that, we have committed millions of dollars in facilities, trainers, and visual aids to introduce people to our concept, philosophies and procedures. This commitment is ongoing and we believe it is one area that separates us from our competitors.

Return on investment will drive up earnings per share, attract new investors, and retain current investors."
—**Phil Barksdale**

Commitment to quality products . . . to a quality organization . . . and to a planning process are three precepts that have aided us. Some of this may apply to others, some may not. I think it's incumbent upon each company to analyze its own condition and develop its own philosophies dependent on its own unique characteristics that will spell the difference between success and failure.

Phil Barksdale

Vice President

Holiday Inns, Inc.

Until recently, we gauged success primarily with earnings per share as the standard barometer or measurement. We considered unit growth and expansion as the second most important measure. We are beginning to revise this way of thinking.

Today, we define success in terms of profitability, that is return on investment. We have come to grips with the issue of increasing real sales growth per unit.

In this industry, successful companies have been able to increase real sales per unit. Marginal performers may have grown in terms of units, but they have not been able to show real sales growth. We have also seen how poor operational performance and weak middle-management strength have contributed to failure. And very often, among poor performers, their management failed to understand where they were in terms of the life cycle of their product.

Traditionally, size (number of units) has represented success in this industry. Today, for the most part, size is not as important a factor in achieving success as real sales growth per store.

Industry problems

One of the key issues facing a foodservice company today is inflation, particularly rising food and labor costs and the decrease in disposable income.

We are also concerned not only about increases in the cost of gasoline but the possibility of a decreasing fuel supply.

Another problem with which we all have to deal is our ability to pass along some of these rising costs to our customers without losing sales. We have to learn to handle this problem through better marketing and better operational programs.

We are a maturing industry facing saturation and as this process develops it is going to impact by slowing growth in some areas of the country.

Success criteria

In light of this, should we change the existing measures of success? And with what should we replace them?

Internally, R.O.I. must be a key measure of success given the current cost of capital. Return on investment will drive up the earnings per share and that will attract new investors and retain current ones.

Another question relative to growth and success is: How does top management perceive the business? I believe how top managers perceive their businesses is related to the segment of the market in

Civilian Per Capita Consumption of Meat and Fish
(Retail Weight in Pounds)

Figure 12

	1960	1970	1973	1974	1975	1976	1977	1978	1979*
Red Meats	134.1	151.4	142.6	152.5	145.5	155.3	154.6	149.3	145.8
Beef	64.3	84.1	81.1	86.4	88.9	95.7	93.2	88.9	77.9
Veal	5.2	2.4	1.5	1.9	3.5	3.3	3.2	2.5	1.7
Lamb and Mutton	4.3	2.9	2.4	2.0	1.8	1.7	1.5	1.4	1.4
Pork	60.3	62.0	57.6	62.2	51.2	54.6	56.7	56.5	64.8
Fish *(edible weight)*	10.3	11.8	12.9	12.2	12.3	13.0	12.8	13.4	13.7
Poultry	34.0	48.5	49.2	50.0	49.2	52.5	54.1	57.1	62.0
Chicken	27.8	40.5	40.7	41.1	40.6	43.3	44.9	47.7	51.8
Turkey	6.2	8.0	8.5	8.9	8.6	9.2	9.2	9.4	10.2

** Estimated.*

Source: U.S. Department of Agriculture.

which they do business. Some would place greater emphasis on marketing of the concept while others would place more emphasis on operations. However, both would consider themselves as being in the service business. But the interpretation of the word service could be misunderstood. Service implies satisfied customers, which in turn is related to the customer's perceived value. Service has been rendered only when the customer perceives he has received value for his money.

The employee-variable

We must remember that the foodservice industry is different from other businesses. One important difference is that the final product and the means through which it is served is a function of the training, morale and attitude of the employee. This extreme vulnerability to the employee-variable differentiates the restaurant industry from all other businesses.

Customers ultimately determine the success or failure of restaurant ventures. There must be a clear focus on the customer. Manage the customer, not just the employee.

Because we are in a service business we must motivate and train personnel, we have to reduce turnover and deal with the issue of turnover. We also have to understand the customer. We must know his needs and develop effective means of fulfilling these needs.

Successful foodservice companies use the professional management tools of strategic planning, research-driven product development, quality control, and an understanding of the consumer's perceived value of his product.

They must also develop superior communication with employees. Communicate well-defined goals, honest, consistent policies, and develop a keen appreciation for the human resource.

Ideally, a successful foodservice company is able to retain the entrepreneurial spirit balanced with professional management.

Fortunately, our growing returns have made acquisitions in our industry attractive to professionally managed companies. The result has been an infusion of professional management concepts.

What will be required of a successful company as it moves through the 1980s? I see five keys:

1. While not having total participatory management, improved communication and input from the employee is essential. There must be better communication flowing in both directions, management to employee and vice-versa.

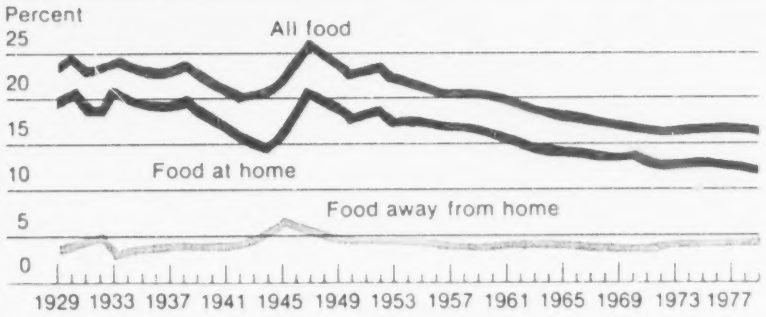
2. A re-evaluation of the organization and its management tools should be an on-going process. New organizations should evolve to replace ineffective structures and new management tools developed to deal with a changing organization.

3. An atmosphere and spirit of trust should be created. Points of view should be expressed openly without fear of reprisal.

4. Concern with helping people relate to more information about their business and adjust to the demands for performance dictated by this information and the controls it will create.

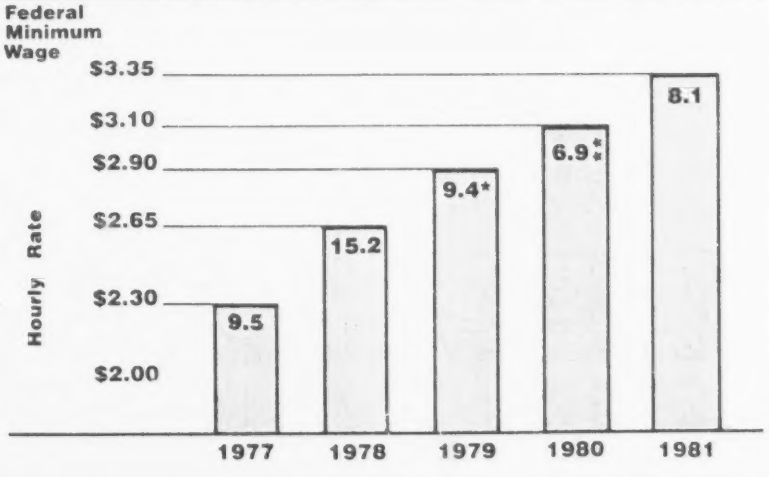
5. Well-balanced decision-makers, acting on time with strong planning skills.

Expenditures for Food as a Percent of Disposable Personal Income, 1929-1979 *Figure 13*



Source: Department of Commerce

Minimum Wage Escalation (percent change) *Figure 14*



*For tipped personnel, the wage hike was 20.4 percent due to the reduction in tip credit from 50 percent to 45 percent of the minimum wage.

**For tipped personnel, the wage hike was 16.6 percent with tip credit set at 40 percent.

John Farquharson

President, Institutional Services

ARA Services, Inc.

Our objectives in the segment of the industry that we serve is "growth with quality." We feel that our most important asset is our people. Unlike most dining businesses, we operate in someone else's house. We don't own our establishment. We operate in IBM or Boeing or McDonnell Douglas. We have to manage to their specifications and design our management training so that our managers can respond to a variety of needs. We can't train managers to do a specific duty and know that this will mean success throughout the country.

I saw an indication of this last week. I was here in the Louisiana Gulf visiting offshore oil well foodservice operations. We feed the crews on the rigs in the Gulf. And their specifications are obviously much different that a hospital dietary program or a college dining program. Management has to plan for all of these activities. Basically, when I go to talk to them, I go with a plain piece of paper and develop an approach to meet their specific needs from scratch. We must continue to encourage this thought process in our segment of the industry.

I've been with the company twenty years and we have seen a dramatic growth. We've been developing new business around the country, including Alaska and Hawaii. We operate in excess of 300 colleges, in excess of 300 hospitals and about 100 public school districts, and for the most part, each operation has different needs. We must meet these needs and always keep in mind that we're no better than the last meal we've served.

We realize that to continue to grow, we've got to do a couple of things and do them more effectively than we've done in the past. For example, we must pay more attention to the balance sheet. In the past, the industry looked very closely at the P&L. We look very closely at accounts we take. We won't take them unless they provide an adequate return. The key problem area, I feel, in our segment is in the untrained manager, the inflexible manager. We spend a lot of time and dollars in the training and development of our managers. We feel that our continued success is in the selection, training and supervision of quality management.

There seems to be a certain excitement about being involved in foodservice . . . the Alaska Pipeline, the Olympics, serving a college community, etc. The managers, over time, see a diversity of operations so an individual can gain experience in many different parts of the food business while still having a career with the same company. We have 46,000 employees in the Institutional division of ARA. Having them feel that they are part of a team that provides a very meaningful service to college students, people at work or patients in the hospitals, is an important objective for us.

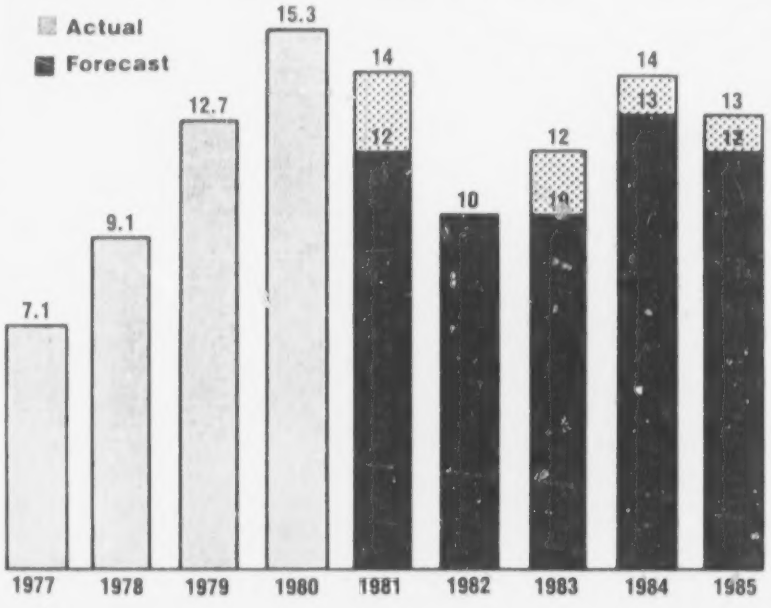
Even our advertising is pointed to our employees. We're proud of what they do and we want them to know it.

We, at ARA, are optimistic about the future of our industry and our role in that future.

> "The key problem area in our segment is in the untrained manager, the inflexible manager. We spend a lot of time and dollars in the training and development of our managers. We feel that our continued success is in the selection, training and supervision of quality management."
>
> —John Farquharson

The Double-Digit Prime Rate *Figure 15*

% Rate *Source: Citibank, N.A., prime rate averaged over 12 months*



Joseph Lee

President, Restaurant Division

General Mills

Success has historically been defined by the industry as the ability to grow quickly, to build lots of units and to see very fast earnings per share growth. I think we'll be seeing our definition of success change to include market-share level of profitability and high return on investment.

Why are some successful and others are not? Usually, when I analyze a nonsuccessful company, I see a company that has lost control of its operations. Occasionally, I'll see product-cost increases that can't justifiably be passed onto the customer; and this reality forces severe margin shrinkage that ultimately results in failure.

Another major cause of failure is that some corporations which acquire restaurant companies are not sensitive to the restaurant business and stifle the entrepreneural spirit through too much corporate policy. I do believe that size is a factor. It's both a plus and a minus. Size works against effective communication but certainly does give you presence in the market place.

Concerning the question, "Is viability a concern"? Sure, Viability is a concern. It always has been and probably always will be. There are more choices today so the marginal operator or the old concept may be more likely to lose out. Viability relates to the marketing definition of "providing the right product at the right price and the right location."

I think the key vulnerabilities of the restaurant business are: inflation, and government over-regulation; followed by labor shortage, high turnover in the industry, and the training costs that result from that turnover.

The cost and availability of energy, and the fact that sites are becoming more scarce also make us vulnerable.

Keys to success

I do think we need new definitions of success. As I have said before, we need to put more emphasis on market share, more emphasis on profitability and more emphasis on return on investment while developing a very strong management base.

Top management in our industry should realize that we're in the business to serve customers, to serve employees and to serve shareholders. We must also remember that we are in a risky business; a business that is easy to enter and exit, and a business that's cyclical. The implication of this perception: We are in business first for the customer; we must always be aware of the needs and demands of the customers, and we must be prepared for change.

We must also have controls, especially as a chain grows, if we want to achieve consistency in our performance. We also have to be aware of government regulation and its effect on all phases of our business.

Besides constantly competing with each other for the best locations, I believe that restaurants do compete on management policies: the decision to advertise versus not to advertise; the issues of compensation; site selection; growth rates; and most important, the level of decentralization.

The most successful management style in the restaurant business in the 1980s will be one that encourages good strategic planning and that allows for risk-taking by willingly taking on carefully planned new ventures/concepts. To be successful in the 80s, operators will also have to adopt a decentralizing management style—decentralizing operations and balancing that policy with centralized policy-making at the corporate level.

"To be successful in the 80s, operators will have to adopt decentralized management."—**Joe Lee**

Farquharson explains ARA's "growth with quality" objective.

Management caliber

The industry is attracting top caliber management, and we will attract stronger people as larger organizations emerge.

To succeed in the future, we will require people with broader management skills: operations, marketing, and financial skills. And things are improving in this area. We're seeing better foodservice management education. For example, in 1974, 41 colleges had foodservice management programs, while in 1980, 84 colleges had foodservice

management programs. And in the last three years, there has been a 60 percent increase in graduates of these programs.

Today, the old strategies aren't working as well as they had in the past. Ultimately, the outcome for companies employing strategies that don't change will be lowered earnings. What are the new strategies? I suggest companies should: (1) increase the decentralization of their management structure; (2) continue to be sensitive to changes in consumer preferences; (3) spend more time training; (4) increase their participation in government, (5) invest in more labor-saving equipment, and more energy-efficient equipment; (6) improve their financial analysis capabilities, and (7) improve their system of site location.

In order to implement these new strategies, we need to have a well-defined plan which involves all levels of management. Then, periodically, we've got to evaluate ourselves against our own benchmarks and against others in the industry.

George Rice *continued from page 177*

these macro-economic variables independently, it is important to realize that it is the interaction of all of these forces that drives the foodservice economy.

Disposable personal income—Real disposable income which represents income after taxes typically increases 3-to-3.5 percent annually. However, we can see that in the second quarter of 1979, the growth in disposable income began to decline (see figure 3). There is a direct relationship between the growth of DPI and the real growth of the foodservice industry. Thus, it is not a coincidence that in the spring of '79, we saw a drop in customer traffic, which continued to show negative growth for most of 1980. (see figure 2). During the same period, DPI dropped significantly, and posted less than a one percent increase for the entire year.

High inflation, above 10 percent, and a weak economy are expected to hold real income to only a 1.4 percent increase in 1981.

Over the next five years, real disposable income is expected to increase between 2.5 and 3.0 percent annually.

Demographics—Single-person households and two-income families have more than doubled since 1960, while other households have remained relatively flat (see figure 4). These household units are forecasted to continue to grow over the 1980s. Their growth rate works to the benefit of the foodservice industry. Over the next five years we expect single-person households and two-income households to increase by four to five million.

Higher income households have contributed disproportionately to the growth of the foodservice industry. Since 1967, the median household income has increased from $12,000 to $14,000. By 1985, we expect the median income to increase to at least $15,000.

Working women have exerted the greatest force on the growth of the foodservice industry. First, working women add to household incomes; and second, they rely more heavily on away-from-home-meal preparation. In 1974, 54 percent of all women, ages 14-55, were in the workforce. Today, over 62 percent of all women in this age group are working. By 1985, it is expected to reach 65 percent.

Food inflation—When the Consumer Price Index for food increases, it has a negative impact on restaurant sales. Additionally, when the CPI for food-away-from home increases faster than the CPI for food-at-home, restaurant sales suffer added decline.

In the second quarter of 1979, the CPI for food-away-from-home surpassed the CPI for food-at-home. (see figure 5). However, in the fall of 1980, the two lines again crossed in the industry's favor. At-home food prices will increase faster than away-from-home only during the first half of 1981, and then drop to our disadvantage through 1982.

Food inflation is expected to increase by 12 percent in 1981 following an 8.4 percent increase last year. By 1985, food inflation is expected to slow to 7-8 percent.

Travel/transportation — Accompanying the economic downturn in 1979, there was a dramatic increase in crude oil prices which boosted gasoline prices by 35 percent in 1979 and by another 39 percent in 1980 (see figure 6). In addition, a major gasoline shortage occurred in the summer of 1979. Both factors caused a significant curtailment in family driving (see figure 7). And of course, the restaurant industry is heavily dependent on travel.

The Chase CPI forecast for gasoline tells us that we are over the hump of this negative force on our industry. The major increases occurred during 1979-80. We expect retail gasoline prices to increase by only 12-14 percent in 1981, and 10 percent annually through 1985.

Also, after several quarters of negative growth in miles driven per family, we have seen a trend upward in this travel indicator during the last half of 1980.

Forecast—Given the historical data from CREST and the forecasted variables which Chase has identified as driving the commercial foodservice industry, we see the following short and long term outlook for real growth (see figure 11).

Short term—Our 1981 forecast includes a very weak first quarter (Dec.-Feb.), with some strength starting to show from March onward; but resulting in a real growth rate of minus one percent, with nominal sales increasing 12.8 percent in 1981.

Long term—Following 1981, real growth is forecast at three percent-plus for the next two-to-three years, with nominal sales growth between 13 and 16 percent annually. If this occurs, and we feel it will, the commercial portion of the industry will surpass the sales and traffic levels of 1979 in real terms by late 1982.

Strategic planning: Part I

Touche Ross provides general management consulting assistance on a wide range of strategic and business policy issues. This is the first of a three-part series on strategic planning for the restaurant industry by Touche Ross, based on its presentation at the Restaurant Business Roundtable, of which it was a co-sponsor. In subsequent issues, Touche Ross will discuss: In Part II, a strategic planning model tailored specifically for foodservice businesses; and in Part III, the implementation of strategic plans.

Ram Capoor
Management Consultant

Touche Ross & Co.

The foodservice industry is an industry that is maturing. You are facing a softening consumer demand. You are facing rising prices and increased cost pressures. Many companies have curtailed expansion programs. You operate in a market of changing demographics, changing meal patterns, and intensive inter-segment competition.

To help business managers think through strategies for the restaurant industry, we at Touche Ross have developed a framework for the strategy development with nine major elements as shown in *Exhibit I.*

Now let us start with the first point in the strategic framework. We believe that it is very important to recognize the uniqueness of the service business that you are in. What do we mean when we say that service businesses are unique? To begin with, we need to recognize that most of our traditional planning vocabulary is manufacturing oriented.

"Because manufacturing has been the dominant economic force of the last century, most managers have been educated through experience or formal education to think about strategic management in product-oriented terms. Unfortunately, a large part of this experience is irrelevant to the management of many service businesses. The general manager of a service business must develop a healthy skepticism about his and others' approaches to strategy." (From Dan R. E. Thomas, "Strategy is Different in Service Business," *Harvard Business Review,* July-August, 1978.)

We can identify the shortcomings of product concepts as they apply to the service business using the matrix in *Exhibit II.*

The key difference between a manufacturing and service business is that they have different components as shown in *Exhibit III.*

When talking about the service business most people tend to focus on the process component which in the foodservice industry is the process that results in the delivery of meals to customers. However, it is very important to recognize the interactive component and the customer component of the service business.

The interactive component in the foodservice business is, for example, the interaction between the waitress/waiter and the customer in the actual delivery of service, but also includes interactions of managers, bus-boys, cashiers, etc. with customers.

Exhibit 1.

Suggested Strategic Framework

1. Recognize service business uniqueness
2. Define business in terms of markets (not products)
3. Segment markets based on strengths and opportunities
4. Establish Strategic Business Units (SBUs) in terms of business and market segments
5. Formulate success model for each SBU
6. Develop strategies for execution
7. Organize to execute
8. Establish management controls
9. Monitor progress/variances, adapt

The customer component in foodservice is the customer's role in the transaction, his behavior relative to his expectations and needs. In a service business, every service occasion to each customer is a unique event.

The process component in the foodservice industry or any other service industry offers limited opportunities for innovation. Even when innovation occurs, like a new method of food preparation or storage, it is easily copied. The opportunity for differentiation lies in the interactive component of your service. It cannot be completely standardized because human beings cannot be standardized, both servers and customers have different moods and attitudes from one moment to another.

This is the area where a foodservice company can best create a perception of value-added, assuming it serves quality products. If the company succeeds in developing the right attitude among its servers—in a way that the customer perceives value-added—this will be a major differentiating factor, and will be difficult to copy.

Because of these unique features, we believe that foodservice companies should define the business in terms of markets and not products. One way to think of company or a company's strategy is to do so in terms of the concept of the driving force. The driving force of a company is the primary factor which drives that company's management activities and strategies.

A product-driven company thinks in terms of products. They develop new products similar to old products. They look for new momentum for their products. Their

continued on page 200

ideas do not come from the definition of the market place. They start with the product idea and still live with the product definition of the market. Examples of product companies abound, a company that calls itself an office-products company—or a hamburger company, or seafood restaurant, etc.—is product driven.

Companies can also be operationally driven, for example, a company which has as its major objective to be the least cost producer. This is common in commodity business like paper and carton producers. Companies where the motivation is to build a portfolio of businesses which satisfy certain established financial criteria—such as the achievement of a specified return—are financially driven. Conglomerates in many disparate businesses, like City Investing, are good examples of financially driven companies.

Companies are market driven when they say: "Here's a specific market we are trying to serve. What, therefore, should we offer to that market place? What services should we provide?" Some of the premier consumer products companies, like Proctor & Gamble, and Norton Simon, are examples of market driven companies even though they sell products.

Based on our observations, we believe that in the past, foodservice industry participants have been largely product driven and have seen themselves as being in the hamburger business, the fish business or the doughnut business, etc.

We would suggest that today, given what we have learned about the changing environment, given the fact that there is so much competition, you need to know who really is your customer. And you need to recognize that there are different customers, with different needs representing different markets. Is it families in the urban Northeast in certain age groups and certain income groups or is it an occupational group?

Most businesses have more than one customer set, the more there are the more important it is to understand who they are. Then, to understand why they come to you and when, as well as the reasons and times they don't think they need your service.

How should a foodservice company identify its markets and segment them? Market Segmentation must be based on strengths and opportunities. In the foodservice business there are many segmentation variables: age, sex, region, occupation, income, meal occasion, location, and activity.

There is no one right cut. You must start with the needs your business currently satisfies, and then define the customer sets you serve.

This should lead to the establishment of Strategic Business Units, preferably separate business units for each different major market you serve.

continued on page 202

Exhibit 3

A Service Has Three Components:

1. Core—Basic Process—Finite Number of Variations
2. Interactive—Infinite Number of Variations *Delivered* in Partnership
3. Customer—Infinite Number of Needs/Expectations Received in Partnership

PROCESS COMPONENT	
Core service/ Basic service Usually a process: • Airline flight • Loan transaction • Meal occasion • Audit process	• Process component may be standardized, mechanized, etc. ▪ Cannot be inventoried/stored ▪ Little opportunity for perception of value-added by customer ▪ Easily copied ▪ Maybe capital intensive ▪ Little opportunity for differentiation

INTERACTIVE COMPONENT DELIVERED BY PROVIDER	
Interactive component: • Infinite variation	• Interactive component cannot be totally standardized • Great opportunity for perception of value-added by and with customer • Difficult to copy • Great opportunity for differentiation

CUSTOMER COMPONENT	
▪ Expectation ▪ Need	• Customer component is infinite in terms of: ▪ No. cust. x no. of services x no. of opportunities to serve ▪ Expectations ▪ Needs

For a foodservice company with one concept, geography may be the major segmentation variable between markets. Thus each major geographical market area could become an SBU. What does that mean? It should mean that each SBU should be as stand-alone a business unit as possible with its own general manager and as full a complement of line and staff functions as feasible.

A SBU should be a self-contained mini-chain within a chain. Current practice in the industry by contrast is to organize functionally (operations, real estate, marketing, finance, etc.) at the top and then to break-out functions like operations regionally. Naturally, companies organized into SBUs will require each SBU to adhere to certain common guidelines and policies. The SBU concept is common-place in the manufacturing sector, pioneered by companies like G.E., but of relatively recent vintage in the service industry. Citibank has been a leader in the services sector.

Why organize by SBU? SBU management encourages entrepreneurial behavior. It provides the SBU general manager with most of the resources he needs to get the job done and he can be held accountable for the results. You can build pride, team spirit, and good people with the SBU concept. □

Exhibit 2

Shortcomings of Product Concepts When Applied to Service Businesses*

Product Concept	Application to Service Business
• Physical reality of product provides simple but powerful base on which to build a business description.	• Services are more abstract and more variable than products.
• Capital is the most common barrier to entry of competition.	• Building barriers to entry is generally more difficult, or at least must be done in less traditional ways.
• Operating leverage can be improved by purchasing faster, more reliable machinery.	• More difficult in service businesses, opportunities are there but required different ways of thinking about operations.
• All product oriented companies have ways of determining product cost.	• Difficult to determine what a unit of service is, much less its cost.
• Virtually all product companies have some form of R & D to design, develop, test new products.	• Complicated by lack of physical product; deals instead with people and concepts, difficult to test market.

**Summarized From Dan R.E. Thomas, "Strategy Is Different In Service Business", Harvard Business Review, July-August, 1978.*

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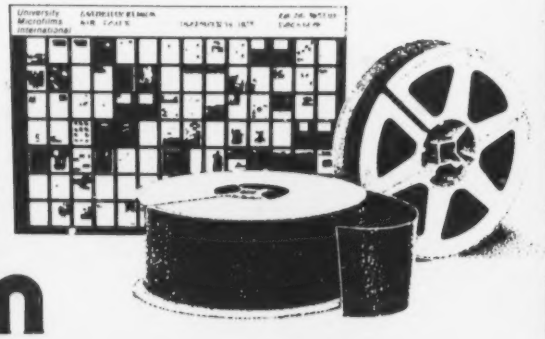

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Fire Safety

Can we do more?

by Denise M. Garbedian

The cost of fire reaches beyond the loss of a business. Accordingly, concerned operators should carefully examine their units.

"There was flame and smoke and it just rolled into the room and it was the blackest smoke I'd ever seen. The only way (to describe it was) if you could just take oil and get it to roll in mid-air. . . . Up until that time everybody was orderly. There wasn't any chaos—no screaming, no panicking. It was when the people saw the smoke and the fire that they became panicky and started screaming. I knew this was it; that we were going to die."—Excerpt from an interview with one of the survivors of the 1977 Beverly Hills Supper Club fire.

The cost of fire reaches far beyond the destruction of a business. Along with every fire comes the risk of injury or death to customer employee, and/or firefighter. The price tag for a human life is too high for the responsible restaurateur or hotelier to afford.

However, even the most conscientious operator can get tangled in the web of factors that might contribute to the inception and spread of a fire.

Modern architecture and engineering, slack fire codes and their (lack of) enforcement are potential hazards. These can combine with combustible design and building materials, poor evacuation procedures, sloppy "housekeeping", lax maintenance and insufficient means of egress to turn an outwardly "model" operation into a veritable tinderbox.

Statistics reflect the tragic impact and consequences of fire and the growing need for more stringent fire safety.

During 1979 fire killed approxi-

mately 11,800 people in the U.S. Total property damage by fire exceeded $4 billion.

According to the National Fire Protection Association (NFPA)—the oldest and largest non-profit fire prevention and investigation organization in the U.S.—26,800 fires per year are reported in the restaurant/tavern classification. The estimated loss from these fires is $65,300,000 or $2,437 per fire. (See table on page 225.)

The American Hotel and Motel Association (AH&MA) claims business and leisure travelers are still safer in a hotel than at home.

According to the AH&MA, 75 percent of all U.S. fires occur in residences. NFPA figures estimate in 1979 there were 11,500 hotel fires (a drop of 4.2 percent from 1978) which accounted for approximately $100,000,000 in property loss.

The end of 1980 was marked by two disastrous lodging fires.

On the morning of November 21, a fire swept through the MGM Grand Hotel in Las Vegas leaving 84 people dead and 679 injured.

Almost two weeks to the day later, 26 people—most of them corporate executives—died in a flash fire that trapped them in a conference room at the Stouffer's Inn in Harrison, New York.

Fire continued to plague the industry into the new year. On February 10, 1981, Las Vegas was once again the scene of a fatal hotel fire. A smokey blaze at the Las Vegas Hilton killed five and injured over 100. It should be noted that both the Stouffer's and Hilton's fires were alleged to involve arson.

The outcry from the shaken public sector requires heightened awareness by both the restaurant and hospitality industries.

Re-examining the cause of the Beverly Hills Supper Club, MGM Grand, Stouffer's Inn or Las Vegas Hilton fires may seem like a moot point. But it is important (and unfortunate) to remember that effective life safety systems evolve from a deadly trial and error process.

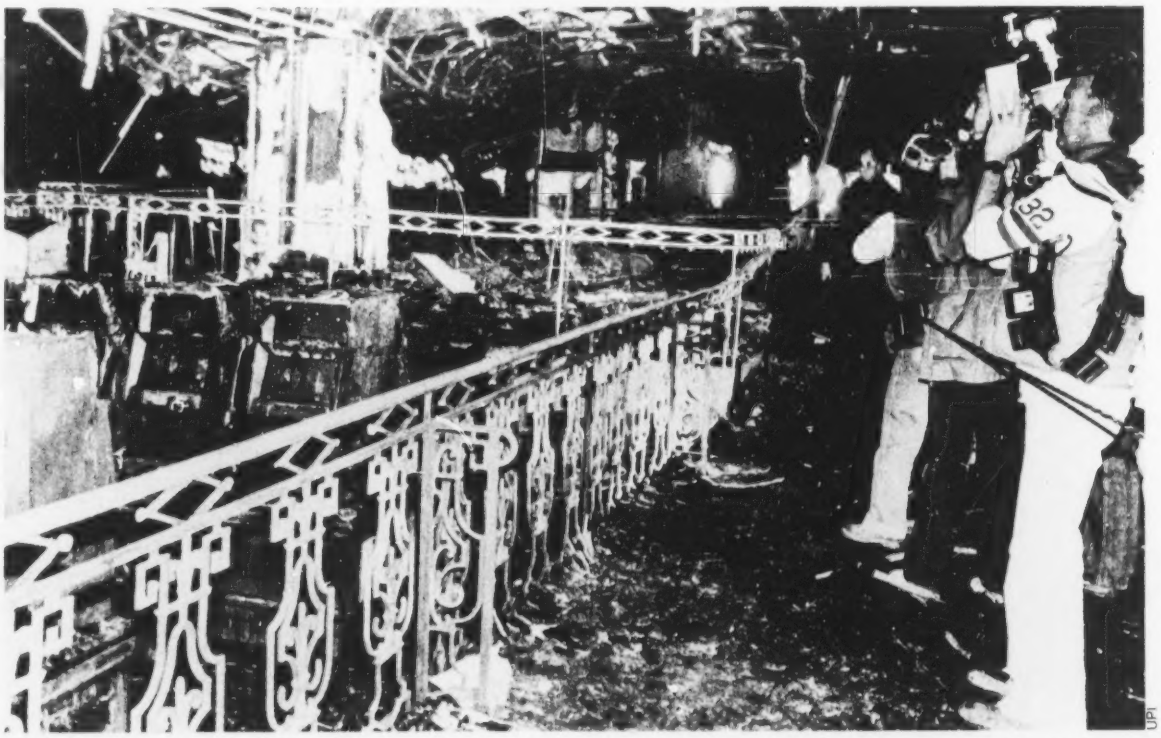
There is a compelling need for a more thorough scrutinization of fire codes and operators should closely examine state and local fire codes as well as investigate available fire prevention and fire protection methods.

Fire prevention methods are measures directed toward *avoidance* of the inception of a fire. Fire protection is defined as methods of providing for fire control or *extinguishment.*

"The greatest problem in fire protection and prevention is lack of uniformity in fire codes," notes Ray Ellis, executive vice president of the AH&MA and director of research and security. "There is no national code and there are 18,000 separate state, county and local jurisdictions nationwide. Each town has its own version of model codes."

The lack of a sprinkler system in the conference room at the Stouffer's Inn in Harrison, New York can be used as an example to demonstrate how codes in neighboring communities can differ.

Had the hotel been located in bordering town of White Plains (approximately six miles away), local codes would have required



Melted slot machines were part of the rubble viewed by cameramen and reporters the day after the MGM Grand fire.

sprinkling in the conference room.

Newspaper reports implied a sprinkler system might have resulted in fewer deaths. However, Ellis contends that such a system would probably have had little impact given the intensity of the heat, the amount of toxic fumes and rapid fire spread.

Currently under investigation for arson, the fire apparently burst through the ceiling as a "ball of flames" and scorched a 100-foot section of the building. The hotel had voluntarily installed sprinklers in the lobby of the center and outside the conference area but had not included the conference room itself.

Life Safety Code

Although there is no mandatory national code, the NFPA's Code for Safety to Life from Fire in Buildings and Structures is one of the most widely used guidelines.

Michael Shenkman, an NFPA spokesman, estimates that 96 percent of the jurisdictions in the U.S. reference or use part of the Life Safety Code in their local codes.

Although the Code does not attempt to cover general fire prevention or building construction features (areas covered in fire prevention or building codes), it does cover construction, protection and occupancy *features* to minimize danger from fire, smoke, fumes or panic before buildings are evacuated.

The Life Safety Code includes specification of the number, size, and arrangement of exit facilities that will allow the prompt escape of occupants from buildings in case of fire.

The Beverly Hills Supper Club fire

The nightmare of the Beverly Hills Supper Club fire should serve as a reminder to restaurant operators of their responsibilities to prevent injury to their employees and patrons and prevent the loss or destruction of their business.

The NFPA documented the blaze in its account: "Reconstruction of a Tragedy—The Beverly Hills Supper Club Fire." According to the report, it was the worst multiple death building fire in the U.S. since the 1942 Cocoanut Grove night club fire in Boston and the sixth worst fire in U.S. history.

> There are approximately 26,800 fires per year in the restaurant/tavern classification. The estimated loss is $65,300,000 or $2,437 per fire.

On the Saturday night of Memorial Day weekend, May 28, 1977, a fire raced through the Beverly Hills Supper Club in Southgate, Kentucky. The blaze claimed the lives of 164 patrons and employees and injured 70 others. The building was completely destroyed.

An investigation of the site was conducted by the NFPA under contract to the National Bureau of Standards and the National Fire Prevention and Control Administration. The following is an account of the NFPA's findings:

"A fire burned in a small unoccupied function room (Zebra Room) on the opposite end of the Club for a considerable time before discovery. The NFPA determined the probable cause to be electrical in nature—See table page 225.—with the ignition of combustible material in a concealed space.

- The restaurant's staff attempted to extinguish the fire before notifying occupants to evacuate from the building and prior to calling the fire department. There was no evacuation plan establishing fire emergency procedures for the Club. Employees were not schooled or drilled in duties they were to perform in case of a fire.
- The number of people in the Cabaret Room (most fatalities were occupants of this area) exceeded by about triple the number of occupants the room could safely accommodate. The number of occupants in the total building on the night of the fire exceeded by about double the number of people that could be safely accommodated.
- The capacity of the means of egress for the Club and especially for the Cabaret Room was not adequate for the occupant load based on square feet per occupant or for the actual number of occupants in the building at the time of the fire.
- The interior finish in the main corridor exceed flame spread allowed for places of assembly in the Life Safety Code and contributed to the rapid spread of the fire from the Zebra Room to the Cabaret Room. (The fire spread across a main corridor of approximately 200 feet in an estimated two to five minutes.)
- The Club was not provided with an automatic sprinkler as required by the codes in effect at the time of the fire.

"As I came out, I turned to look and the people weren't screaming anymore. The smoke had covered them all up. . . . They died because there wasn't any time to get them out. If there had been three more minutes, those people could have gotten out."—Excerpt from an interview with a survivor of the Beverly Hills Supper Club fire.

The commentary by one survivor should be a call to action for owners and operators. Life safety is as dependent on good common sense as it is on sprinkler or smoke detector systems.

Check the number and location of your exits. Are they accessible? Can they be reached quickly?

Operators should check to see that exit signs are well-lighted. If they are not, check the wiring. This is not an expensive job.

In addition, school employees in evacuation procedures. Drill the staff periodically.

Since turnover is a problem in the industry, thoroughly trained managers should review evacuation procedures with employees every six to eight weeks.

Many of the employee actions at the Beverly Hills Supper Club fire were described as "heroic." Hostesses, waiters, waitresses, bartend-

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ers and busboys along with the managers initiated evacuation without previous instruction. And, although evacution was called "calm and orderly" (up until the appearance of dense smoke), this was due to the occupants apparent "lack of appreciation for the seriousness of the emergency" rather than an workable escape plan.

No operator should leave evacuation procedures to chance.

Self-inspection program

Andrew Poledor, director of public health and safety for the NRA, maintains that "good housekeeping" is an important factor in fire prevention. He recommends that a self-inspection program should be conducted at regular intervals. (The NRA provides an inspection checklist.)

Poledor also believes the "ten commandments" of fire safety cover the paramount concerns of protection and prevention. (See box this page.

George Kelly, a former New York City fire marshall and president of Kelroe Associates, a fire consultant firm, agrees with Poledar on the importance of self-inspection. Kelly also suggests that restaurant operators contact their local fire department for guidance.

"When the restaurateur completes the inspection, the results should be sent to the local fire department. This way potential danger spots can be pinpointed," he says.

In addition, Kelly recommends that local fire officials become acquainted with a restaurant or hotel under "normal" conditions rather than a first introduction to a property engulfed in smoke and flames.

"While there is no system that will guarantee that a building is fire proof, a periodic self-inspection, several accessible exits and an effective sprinkler system combine to make a building fire safe," he explains.

Combustible materials

A member of the Kentucky business community points out that families of the victims of the Beverly Hills Supper Club fire are still in litigation with companies that provided the Club's furnishings and materials.

According to the NFPA report the rapid spread of the fire was partly attributable to the presence of "combustible ceiling tile and wood materials .... (that) provided a fuel supply for the continued spread of the fire. ...")

Indeed, the lethal contributions of combustible decor items and furnishings to modern fires are causing growing concern in several sectors. The restaurant and hotel industries should be alerted to these possible hazards.

Although construction techniques are being perfected to control fire, the same cannot be said for materials contained in restaurants, hotels, offices or even residences.

"We are left with, in effect, compartmented fire proof areas," begins Norman DeHaan, a Chicago-based architect and designer. "These areas are controlled incinerators which means the only thing left to burn may be what we put in them .... people and furnishings."

Synthetic materials used in the manufacturing of room furnishings may produce toxic gases which both feed the fire and asphyxiate the victims.

"Over the past ten months major disasters in four hotels, one office building, two nursing homes and a boarding house have resulted in 162 deaths and 500 injuries. The major cause of these deaths were smoke and toxic gases. The major generator of smoke and toxic gases are the buildings furnishings, particularly fire retardant and synthetic products," he emphasizes.

DeHaan is not alone in his recognition of the deadly potential of burning furnishing and decor materials. During the Beverly Hills Supper Club fire, the NFPA describes the smoke as "dark—almost black to the occupants. In addition it would have been extremely irritating causing a burning sensation to the nose and tearing of the eyes. This was due to the nature of materials undergoing combustion, i.e. the carpets and wall paneling."

The account continues to describe the contents of the smoke as containing "toxic gas species with carbon monoxide as the principal gas." In the early stages of the fire this colorless, odorless gas induced, confusion and disorientation. "As the levels of the gas increased in the later stages of the fire, carbon monoxide resulted in unconsciousness and ultimate death to many of the occupants," the report states.

The NFPA preliminary study also indicates that the fire at the

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"Ten commandments" of fire safety

1. Make certain portable fire extinguishers are: properly located and mounted; of the correct type, size and properly identified; and fully charged and maintained.
2. Train all employees in the proper use of portable fire extinguishers.
3. Train employees in conducting a patrons evacuation of your restaurants.
4. Post emergency telephone numbers in appropriate locations.
5. Paths of exit must be: unobstructed, well lighted, equipped with emergency lighting and exit signs.
6. Do not permit the accumulation of refuse or rubbish. Follow recognized housekeeping procedures.
7. Clean your kitchen hood, filters and duct of grease accumulation.
8. Have your kitchen hood's automatic fire protection system inspected and serviced by qualified persons every six months.
9. Have your automatic sprinkler system inspected annually.
10. Inspect your electrical system for: frayed wiring, prohibited use of extension cords, over loading of circuits, clearance around motors to prevent over-heating, and ready accessibility to all electrical panels.

MGM Grand gained fuel from combustibles "such as wooden decorative items and foam plastic padding of chairs and booths." In addition, plastic ceiling panels exploded when ignited and dripped firey molten plastic.

To address the problem of flammability and potentially toxic contents of manmade materials, DeHaan feels the blame should be first placed on chemical companies—who he feels are the villains and source of the problem.

The fire swept across the MGM's kitchen to the front of the building.

He insists that these companies and their products (few of them tested or fire rated) should be regulated by the government.

DeHaan explains: "There is no way of knowing how Chemical A present in the wall paneling and Chemical B present in the carpeting and Chemical C present in the furniture will act and interact in the case of a fire. Will there be an explosion? Are toxic fumes emitted? Nobody knows what will happen. Even the manufacturers don't know."

DeHaan believes the goal is to prevent fires by regulating the use of flammable materials for furnishings. However, this suggested regulation raises what DeHaan himself describes as "questionable regulatory issues."

The first problem is availability. "Owners may, obviously, buy anything, anywhere they wish, nor is there anyway of knowing how, when or where such purchases may be made," he notes.

This is an important area for consideration and the point is well made. It is hard to imagine restaurateurs or hoteliers would agree to regulations that would restrict their buying habits and limit their freedom. And, even if these regulations could be passed, how successfully could they be regulated?

The other stumbling block is, of course, economics. "Unfortunately, costs rears its ugly head . . . few clients want to be told such materials will add 10 percent to 30 percent to their upholstered furnishings cost, limit the selection of materials and restrict the number of suppliers," he continues.

The economic squeeze on operators from all sides and the resulting shrinking margins make higher decor costs seem the least of an operators priorities.

These factors make DeHaan's goal a considerable struggle. However he believes that "regulatory language that encourages design compliance without penalizing the design professionals who recognize their responsibility as well as their liability" may be a step towards a solution.

Whether or not restaurant and hotel operators agree with DeHaan about regulatory measures, they should take note of the advice he gives his fellow architect and designers for his message is certainly applicable to all:

"We must be aware of the problem and we must be willing to do something about it. We must become aware of dangerous and potentially toxic materials and what happens when a product is ignited. We must be aware of not only local fire regulations but what is happening nationally.

"And finally, we should take pride not only in beautiful interiors but their life safety standards as well," he concludes.

Building fire codes

DeHaan's suggestion of regulatory codes for furnishings seems unachievable in light of the difficulty in regulating—and enforcing the building codes.

As stated previously, the stringency or laxity of fire codes depends entirely on the locale.

New York City and California fire codes are generally considered to be the toughest in the nation—perhaps a result of the density of population.

In a listing of fire death rates in 50 U.S. cities (1974-1977 average), New York City ranks 25th with 36.4 deaths per million persons. (These figures are from the National Center for Health Statistics. See table on page 228.)

Fire consultant Kelly points out that hundreds of Manhattan restaurants fall under the jurisdiction of New York City's Local Law #41. (It is also known as the Blue Angel Law—named after the Blue Angel Cabaret. This was the site of a fire where six people were killed. The law went into effect January 13, 1979.) Local Law #41 covers places of assembly (more than 75 people) and requires emergency lighting, a fire alarm system connected to the local station and full sprinkling throughout areas designated as "cabarets."

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Designing fire-safe buildings

Partnerships bonded by a spirit of cooperation among the authorities (engineers, architects, plumbers, owners, etc.) involved in restaurant or hotel construction often result in a fire-safe structure built at an affordable cost.

"Before the building goes up—as early as the design stage—the owner should send an architect and an engineer to meet with the local fire marshall and other authorities," says Earl McKinney, an architect and principal in the Kentucky-based firm of Hammill & McKinney, Architects & Engineers, Inc. "This will help insure that the building will meet life safety requirements."

Thomas Mosgrove, an independent insurance agent in the same area, agrees with McKinney and offers an example of this type of cooperation in action.

"Recently, the owner of a proposed dinner theater took the plans to the Fire Rating Bureau. The bureau issued the design a rating which should have resulted in exorbitant rates. The owner then came back to me and we got together with the architect and engineer.

"We worked on the areas that had been pinpointed as possible trouble spots. As a result, when the owner took the redesigned plans back to the bureau, the new fire rating was much better (lower)," explains Mosgrove.

Due to this joint effort, the owner increased the life safety features of his dinner theatre and cut his insurance costs to a much more affordable level.

Advising owners about methods to keep their units fire safe and pull down insurance costs as well can also be done for existing buildings.

Proper wiring is a vital concern as electrical causes are second only to arson as the source of fires. Inadequate or poorly installed wiring can drive up insurance rates as well as cause a fire hazard.

McKinney believes that the aluminum wire commonly found in fluorescent lighting fixtures largely contributes to the ignition of electrical fires.

According to McKinney, the wire (which he says has a tendency to arch rather than remain tightly connected) shorts out and overloads. As a result, the loose connection can cause a short to simmer, even when the lights are off. Eventually, the short can touch off a fire.

McKinney strongly urges that the fire codes should require P ballasts (at a cost of $5 more per fixture) be installed in its place.

"I've investigated a number of fires where the cause was a loose wire. I believe that it's the little things that make a difference. The inclusion of P ballasts in lighting fixtures would, in my opinion, dramatically reduce the number of electrical fires," McKinney contends.

The key to fire safety is flame spread and the key to containing flame spread is a sprinkler system.

"Sprinklers are approximately 90 percent effective in controlling flame spread. In our restaurant designs we include specialized sprinkler heads that go off when the temperature reaches 165° to 175°. When the area has cooled down to a more normal temperature, the heads shut off to avoid flooding," explains McKinney.

While installation of a sprinkler system in a new building costs $1.65 to $2 per square foot, retrofitting can push the cost to as high as $4 for the same space.

However, Mosgrove points out that retrofitting an older building with a sprinkler system can cut insurance rates. Over a period of time, this savings on rates will payback the operator for his investment. Mosgrove contends that five years can be considered a "good barometer" for payback.

However, sometimes the rates remain out of proportion and the cost to retrofit outweighs the savings. In this case, Mosgrove suggests the operators should work with the insurance company (and the architects and engineer) to find other solutions.

He also points out the most frequent back-of-the-house problem is the inadequate servicing of ducts and hoods.

Restaurants that feature fried foods must be especially careful due to grease accumulation. As McKinney points out the flash point of grease lowers as it ages. Both McKinney and Mosgrove maintain that good housekeeping is a must for hoods and ducts.

"People working in a busy restaurant sometimes do not take the necessary time for cleaning and maintenance. It is imperative. For example, often filters are not taken down and cleaned. During an inspection this would be spotted quickly," Mosgrove points out.

One cleaning procedure he mentions is the "scrape and powder" method. "Scraping and powdering the hoods and ducts is a good effort but the powder must stick to something to stay in place and that something is grease," notes Mosgrove.

From his investigations of back-of-the house cleaning operations, he recommends the chemical wash method as the most effective.

"Sometimes there is a malfunction in the range and hood protection. Employees should know how to manually shut off the system. In addition, they should be trained to correctly operate extinguishers and know evacuation routes," adds Mosgrove. *continued on page 225*

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In addition, a fire guard (an employee trained in evacuation and tested by the fire department) must, prior to opening, inspect the exits to insure they are open and accessible and check fire extinguishers to see they are in working order.

Since it is mandatory for the fire guard to be present the entire time a building is open, restaurants must make provisions for shifts. If there are two shifts per day, there must be two trained fire guards available; one to cover each shift.

If operators do not comply with Local Law #41, it is possible for the building department to refuse renewals of the "Application for Place of Assembly."

The MGM Grand fire

Regardless of how stringent fire codes may be, they are useless without strict enforcement. The MGM Grand fire is a tragic example of how costly this problem can be.

Numerous code violations surfaced during the U.S. Fire Administration, NFPA and Clark County (Nevada) investigation of the aftermath of the MGM Grand fire in Las Vegas.

Background

According to the NFPA's preliminary study, the fire was discovered at approximately 7:10 a.m. by an employee. The fire was located in a bus station in a restaurant called the Deli which was closed for business at the time.

(Like the Supper Club fire, the probable cause of ignition of the fire was electrical in nature.)

Due to the magnitude of the fire, attempts by the hotel's security guards to contain the fire were unsuccessful. The Clark County Fire Department was notified at approximately 7:15 a.m.

"There is no evidence that the building fire alarm was sounded," states the report.

The account indicates "the presence of fuel (combustible decor and furnishings items), air supply and a large undivided area allowed for extremely rapid fire spread and heavy smoke production."

A "flashover" (simultaneous ignition of all combustible materials within the room due to heat) of the fire occurred at appro[illegible]ly 7:15 a.m. A fireball b[illegible]ugh the public areas of the c[illegible] at an estimated speed of 17 fe[illegible]per second.

(The fourteen victims found on the casino level were dead due to the direct result of heat and flames rather than smoke or fumes.)

The report continues: "There were limited or non-existent barriers to fire spread which allowed the spread of heat, smoke and other products of combustion to the building's upper floors.

"These shafts included elevators, stairs and shafts located at seismic joints (an earthquake protection feature) in the high rise tower." (Apparently these joints eventually acted as conduits for smoke and fumes.)

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ORIGIN OF RESTAURANT FIRES

Kitchen	30.4%
Dining area	14.8
Basement or heating room	13.0
Storage area	9.6
Concealed space	9.6
Rest rooms	1.7
Other areas	20.9
	100.0%

NUMBER OF FIRES (BY RETAIL CLASSIFICATION)

Classification	Annual number of fires	Loss per fire
Drug Stores	3,300	$ 3,909
Grocery stores	7,800	5,244
Food product plants	4,900	11,959
Laundries	3,100	2,290
Service stations	6,000	2,367
Restaurants	26,800	2,437

CAUSES OF RESTAURANT FIRES

Incendiary (Arson)		32.3%
Igniting flammable liquids	21.3	
Igniting papers or trash	4.7	
Igniting other or unknown materials	6.3	
Electrical Causes		22.7
Faulty Wiring	13.4	
Electrical appliances (except cooking and heating)	9.3	
Cooking		15.8
Igniting grease or fat not in fryers or ducts	6.3	
Involving deep fat fryers	5.5	
Involving gas	2.4	
Involving other facts	1.6	
Smoking		14.2
Igniting paper or trash	11.0	
Igniting furnishings	3.2	
Exhaust Ducts		7.1
Ignition of grease in dust	6.3	
Other factors	0.8	
Heating Equipment		6.3
Other Causes		1.6
TOTAL		100.0%

NFPA figures compiled over a three year period.

Since no alarm was activated, occupants became aware of the fire by "smelling or seeing smoke, people yelling" or the presence of helicopters that arrived for evacuation purposes.

Total evacuation of the building took nearly four hours and a large number of guests were trapped in their rooms.

According to the report: "Of the 64 victims above the casino level, 29 were located in guest rooms, 21 were in corridors and elevator lobbies, five were in elevators and nine were in stair enclosures.

"Other than automatic sprinklers (which did not cover the gambling casino or the high rise tower), there were not automatic detection devices in the building."

A front view of the MGM Grand. The first fire department trucks that arrived were unable to gain access through the front entrance.

Violations

One violation that may have contributed to the large loss of life at the MGM Grand, was the discovery of holes in the fire walls. There is speculation by informed sources that these holes may have been the result of construction efforts that were later abandoned. And the holes were never filled in.

Some of the experts interviewed also noted the presence of disabled dampers that could not close when fusible links melted. Other dampers did not close completely. This allowed for distribution of dense smoke, carbon monoxide and other articles of combustion through the HVAC system.

In addition, the NFPA preliminary study points out that three of the interior stairs were not enclosed with two-hour fire-rated construction and that non-rated access panels allowed fire and products of combustion to spread into these stairs.

"The spread of smoke into the stairs directly contributed to several fatalities," continues the report.

Due to the legalities involved, the preliminary study avoids allocating any blame.

The MGM Grand fire raises the sensitive issues of (lack of) compliance with fire codes and also safety in high rise buildings.

At press time, the MGM Grand remained unavailable for comment.

In general, fire codes attempt three things: to save lives; to contain the fire and prevent the spread of smoke and toxic fumes through construction standards; and control the nature of materials by rating their flame spread, fuel contribution and smoke.

Yet, fire codes are often thwarted in these goals by the options adopted by the thousands of jurisdictions.

A number of people interviewed noted that since the burden of implementation falls on the local level, competition of authority develops among those involved (fire marshalls, engineers, architects, contractors, owners, etc.).

As a result fire codes sometimes become the subject of political and economic pressures.

For example, restrictive codes may inhibit construction. During slow economic times, officials of municipalities may be tempted to make exceptions in order to attract business, bring in added income and boost employment.

On the other hand, a city may have a cohesive set of fire codes, yet economic restraints or lack of manpower may prevent effective enforcement.

In a recent series on fire safety, *The Wall Street Journal* presents the problem in this way:

"There are many reasons why some communities and building owners take a loose attitude towards fire codes, but they all boil down to one thing: money.

"Politicians eager to attract business and improve the local tax base often grant variances to fire and building codes or press the fire inspectors to look the other way on seemingly minor violations. Sometimes the inspectors succumb to bribes."

The area is certainly a controversial one but it must be carefully considered. In the cases of flagrant violations (such as too few exits at the Beverly Hills Supper Club or holes punched into the fire walls at the MGM Grand), informed sources speculate that questions are certain to arise on the amount of selective "head turning" that occurs in local municipalities.

Ellis of the AH&MA notes that economics, unfortunately, prohibit the adoption of the ultimate in fire safety material and building design.

As an example, he points out, the installation of a sprinkler system in a new property will cost approximately $1.65 per foot. However, to retrofit that same area, a sprinkler system would cost almost four times that amount or $4 per foot. That amount may be prohibitive for a corporation and out of reach for

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the mom & pop operator.

One possible solution to the cost barrier could be the passage of special tax breaks similar to current energy credits. This would provide a break for operators who voluntarily upgrade their fire safety system beyond the minimum level required by law.

Complicating the matter further is the so-called "grandfather" clause. This means that although a regulatory action may be required (effective at a given date), it is *not* retroactive. Existing buildings or those in the process of construction are not mandated by law to incorporate the new regulatory action.

"This is a situation which occurred at the MGM Grand. While the hotel met the life safety criteria when it was built, each time a code change occurred the building's facilities were not updated. That was not required by law. This is the 'grandfather' clause in action," Ellis adds.

However, he is quick to point out that new legislation is beginning to require retrofitting in some cases and that the "grandfather" clause may some day be eliminated.

For example, in New York City, the newly proposed Stern Bill would require existing hotels to be retrofitted for smoke and/or heat detectors throughout. It would also require new properties to install sprinklers throughout. Target date for passage of this proposal is December 31, 1981.

"Using the 'grandfather clause' makes no sense to me," says Ellis. "I cannot see building a $175 million establishment, for example, and then neglect the upkeep of the fire safety systems."

High rise safety

Space constraints have pushed commercial development of hotels and offices "up" rather than "out."

As these modern high rises take form, serious fire safety problems have also developed. Much of the new architecture and design has eliminated fire safety features predominant in older structures.

First of all, the actual height of modern buildings is itself a problem. Most fire ladders reach only as high as 100 feet or the equivalent of the seventh floor.

Since older buildings were constructed floor by floor, fires tend to be more compartmentalized as fire is contained by solid walls and floors. Dividing walls from floor to floor are also common features of older buildings and help to localize fire.

In contrast, high rises are built around a steel skeleton with a "core" to hold the HVAC system and elevator banks. The general structure has a tendency to keep heat in the building which increases the potency of a fire.

Another feature in older properties were fewer vents to upper floors, a distinct contrast to today's controlled environment systems. In addition, windows could be opened to allow heat to escape.

Today, central air conditioning and heating systems are an integral part of high rises and in the case of fire can facilitate the spread of heat, smoke and fumes.

During the Las Vegas Hilton fire, smoke reportedly shot up from the 8th floor to upper levels where most of the victims were injured by smoke inhalation.

Other potential fire traps in mod-

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Fire Death Rates in Large Cities

Rank	City	Deaths per million persons*
1	NEWARK	64.8
2	BIRMINGHAM, Ala.	59.8
3.	BOSTON	58.5
4	CLEVELAND	54.0
5	LOUISVILLE, Ky.	53.6
6	BALTIMORE	53.1
7	ATLANTA	52.8
8	PHILADELPHIA	49.9
9	CHICAGO	49.5
10	BUFFALO	47.3
11	WASHINGTON	46.3
12	JERSEY CITY	45.1
13	DETROIT	44.8
14	PORTLAND, Ore.	44.1
15	SAN FRANCISCO	42.9
	TULSA, Okla.	42.9
16	MEMPHIS	42.7
17	PITTSBURGH	42.5
18	OKLAHOMA CITY	42.3
19	FORT WORTH	40.5
20	INDIANAPOLIS	39.2
21	CINCINNATI	38.7
	TOLEDO, Ohio	38.7
22	ST. PAUL	38.4
23	ST. LOUIS	36.7
24	DALLAS	36.6
25	MINNEAPOLIS	36.4
	NEW YORK CITY	36.4
26	NASHVILLE	35.8
27	ROCHESTER	35.6
28	WICHITA, Kan.	34.9
29	NEW ORLEANS	34.8
30	JACKSONVILLE, Fla.	33.4
31	KANSAS CITY, Mo.	32.2
32	AKRON, Ohio	31.8
	SEATTLE	31.8
33	NORFOLK, Va.	31.4
34	CHARLOTTE, N.C.	30.2
	HOUSTON	30.2
	OAKLAND, Calif.	30.2
35	SACRAMENTO, Calif.	28.7
36	PHOENIX	28.2
37	MIAMI	26.7
38	COLUMBUS, Ohio	26.1
39	LOS ANGELES	25.9
40	LONG BEACH, Calif.	25.3
41	TAMPA, Fla.	25.0
42	OMAHA	24.3
43	MILWAUKEE	23.6
44	DENVER	22.7
45	ALBUQUERQUE, N.M.	22.4
46	SAN ANTONIO	22.0
	TUCSON, Ariz.	22.0
47	SAN DIEGO	15.5
48	SAN JOSE, Calif.	14.8
49	AUSTIN, Tex.	10.0
50	EL PASO	9.1
51	HONOLULU	7.1

* 1974-77 average.

Excludes transportation fire deaths and deaths of nonresidents.
Source: National Center for Health Statistics.

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ern architecture are the popular drop ceiling and raised floor. These areas can allow smoke and flame to build up undetected and spread from room to room.

For example, if a fire starts in the plenum (the space above a drop ceiling), combustible gases may build up until they explode through the ceiling creating a fireball that can reach temperatures as high as 1500°.

Located in the buildings "core" modern elevators are danger zones. During a fire it is possible for the elevators to stop at the fire floor leaving its occupants as victims.

Fire consultants suggest elevators should be equipped with a "call back system" which requires a smoke detector in the elevator. When activated, the elevator immediately returns to the lobby level (non-stop) for use by fire fighting personnel only.

Both AH&MA's Ellis and fire consultant Kelly recommend that owners of a building work together with local authorities (fire department, engineers, electricians, etc.) *during construction* to create a fire safe building.

According to Ellis, if existing buildings were built to meet the codes at specific times and are maintained by good housekeeping, they should be as fire-safe as a new building—equipped with modern safety systems. In addition, he suggests that personnel should be trained periodically in evacuation procedures.

Owners should also investigate the various fire safety systems available on the market. (Some of these systems will be detailed as part of our May 15, 1981 cover story on Management Information System.)

"A 'successful fire'—if there is such a thing—is one that is contained; where there is no loss of life," comments Ellis.

While *no* fires are actually desirable, "successful fires" are certainly achievable. In many instances, loss of life results from a combination of ignorance and lack of common sense—two characteristics shared by both the operator and the customer. In light of the recent tragedies, the consumer press has awakened the public sector to potential fire hazards (see box below.) Today, customers may observe their favorite restaurant or hotel with a more discerning eye. Operators must respond to this heightened awareness and should do so quickly.

Some of the solutions are expensive; many are not. But every possibility must be explored to create a "fire-safe" environment for everyone. Short cuts in fire safety can have deadly consequences.

On the consumer side. . .

"Requests for hotel rooms no higher than the seventh floor have increased dramatically over the past few months," says George Kelly, a New York City-based fire consultant who specializes in the lodging industry.

His observation reflects the heightened public awareness about fire safety. A concern that comes on the heels of several recent fatal hotel fires.

Many chains have responded to the new emphasis on fire safety by posting escape routes in rooms or providing publications clearly stating emergency procedures. Bellpersons educating guests about floor exits as they are escorted to their rooms are another indicator of the impact of the recent tragedies.

Since survival in a hotel or office building blaze is currently the number one topic among travelers and workers, the consumer press has been quick to respond. An avalanche of fire safety tips has dominated magazines and newspapers recently.

In response to many requests from the consumer, the American Hotel & Motel Association (AH&MA) compiled a packet of information taken from its Research Department files. (A cover note disclaims the organization's liability and emphasizes that the information included in the packet should not be regarded as industry standards or as recommendations of the AH&MA).

The material contains articles from diverse sources ranging from a letter in the "Dear Abby" column to the National Safety Council's "18 Point Plan Leads Way to Surviving a Blaze."

All of the articles stress basic fire safety tips, the most common of which is: Don't Panic!

As a precautionary measure, New York City-based Chemical Bank, stuffs a pamphlet concerning fire procedures into the ticket envelopes of its traveling executives.

"We started the program about three months ago as a result of the rash of hotel fires," explains Richard G. McCormick, vice president, corporate director of security for the corporation which operates 400 domestic offices.

"We drew the information from a variety of sources including tips that appeared in various articles as well as our own personal experiences," he notes.

McCormick stresses that the publication was not designed to discourage travel. "What we wanted to do was to provide a list of common-sense precautions people can take ahead of time."

The guidelines are divided into five areas: pre-planning; arrival; what to do in case of a fire; what to do if you become trapped and conference rooms.

Although he is unable to predict how long the "envelope stuffing" program might last, McCormick speculates: "I'd be afraid to stop the program. You may miss that one person who doesn't travel often. And that person may be the one you save."